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ABSTRACT

This package introduces college students to the kind of analysis that multinational corporations undertake to assess risks to their business operations due to political and economic conditions. Designed to be completed in 3 weeks, the four exercises enable students to (1) identify the major sources of political risk; (2) determine what social, economic, political, and geographical background factors need to be considered in conducting a political risk analysis; (3) forecast the likelihood of a change in regime, occurrence of political turmoil, or restrictions on international business; and (4) calculate risk ratings that can be used to compare the relative risks in different countries. The methods presented are those developed by the authors for Frost and Sullivan's "World Political Risk Forecast," which uses country studies produced by experts. An annotated bibliography and sample country study on Egypt (1983) from Frost and Sullivan's service are included in the appendices, which comprise over half the document. In addition, students are provided with Prince charts (a system for making political forecasts and devising strategies), decision structure charts, a description of risk ratings for three business sectors, a summary of an 18-month forecast, and a worksheet for calculations. (LH)

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PS24

INTRODUCTION
TO
POLITICAL RISK ANALYSIS

by
William D. Coplin
and
Michael K. O'Leary

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POLICY STUDIES ASSOCIATES

INTRODUCTION TO POLITICAL RISK ANALYSIS

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PS-24

Policy
Studies
Associates

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TO THE INSTRUCTOR AND STUDENTS ON THE OBJECTIVES AND MATERIALS:

THE PRIMARY OBJECTIVE:

This package will provide you with the tools you will need to conduct a general political risk analysis on any country.

UPON COMPLETION OF THIS PACKAGE, YOU WILL BE ABLE TO:

- Identify the major sources of political risk.
- Determine what social, economic, political, and geotraphical background factors need to be considered in conducting a political risk analysis.
- Forecast the likelihood of a change in regime, occurrence of political turmoil, restrictions on international business and trade, or other government decisions that might affect international business.
- Calculate risk ratings that can be used to compare the relative risks in different countries.

TIME SPAN:

Three weeks.

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CHAPTER I: WHAT IS POLITICAL RISK ANALYSIS?

The term "political risk analysis" is used to identify the analysis of political events and conditions that could cause loss to international business. It is usually conducted by businessmen or outside consultants to determine what precautions they should take in protecting their business investments.

The study of political risk analysis is useful to undergraduate and graduate social science students because it is an example of "applied social science." Along with public opinion polls used to guide election candidates and econometric techniques to forecast business trends, political risk analysis represents the integration of academic theory and method with the practical need of decision-makers. Unfortunately, like the other applied social science tools, political risk analysis does not have the precision and legitimacy of the engineering and natural sciences. However, it still represents a systematic approach to collecting and analyzing information so that people can make more informed decisions.

Political risk analysis is used in a wide variety of ways. Some analysts find it valuable in helping them to estimate commodity and currency prices. For example, the Falklands war in Argentina could have slowed the shipment of wheat from Argentina and therefore have led to increased wheat prices. The election of a left-wing government usually means that the currency of that country will decline. Banks use political risk analysis to help them decide how much money to lend a country. Although they may decide to lend money to a country where political instability is forcasted, the knowledge that such instability is a risk will help them decide how much interest to charge and how many other banks they should get to help them share the risk. Companies that export goods to a buyer in another country are worried about whether or not they will receive payment for the goods. They have credit managers whose job it is to estimate the risk of non-payment or payment delays, and to secure bank guarantees or whatever is necessary to make sure the payment is received.

Countries like Zambia and Turkey have payment delays of up to two years in part because of political problems. Other individuals in corporations that use political risk analysis include marketing people whose responsibilities are to see where their products might be sold, risk managers who buy political risk insurance to protect investments, corporate security officers whose responsibility it is to insure the safety of employees and property of their company, and strategic planners who advise the corporation on what new business opportunities and risks exist over the long run.

There are so many uses for political risk analysis that most high-level government and business officials think about political risks on a day-to-day basis. It is often necessary to produce general country studies that all of those concerned can read in order to get the necessary background to ask specific questions about their own particular problem. Once they do this, they then conduct analyses on more specific questions. The tools presented in this learning package can be used for both general and specific analyses. In the remainder of this chapter, we will identify four sources of political risks:

A. Regime Change

B. Political Turmoil

C. Government Restrictions

D. Economic Policies

Each has a different impact on international businesses.

A. Regime Change

A change in regime refers to a major shift in the political leaders responsible for running the country. The change may occur through scheduled elections or through such extra legal methods as assassination, military coup, or revolution. (In some countries, of course, the extra legal and the legitimate blend into one. Bolivia has had nearly 200 regime changes during 160 years of independence.)

The threat posed by regime change is both the circumstances surrounding the change itself and the economic and political consequences resulting from the change. An extra legal change in government or a defensive reaction against an attempted overthrow can disrupt normal economic activities. Banks, custom houses, and borders may be closed. Bureaucracies can stop processing papers. In cases where a civil war erupts from the attempted coup, delays can be even more serious and possibly permanent. At a minimum, these kinds of disruptions can delay payment, but they could lead to destruction of facilities or even government expropriation. Change through legal processes rarely produces the same impact. Even so, in some countries the bureaucracies slow down their activities just before elections as they wait for the new government to organize itself and establish policies.

Even more serious are the political and economic consequences flowing from the change in leadership. Such consequences can be as extreme as the 1979 Iranian revolution where the open economy and free-spending activities disappeared along with the Shah. Or they may be the negligible consequences that usually accompany government changes in Western democracies. Nevertheless, any change in regime can signal a change in the rules of the game for governmental investments and international trade. New government policies regulating trade, determining the value of the currency, controlling the conversion of currency, managing the economy, and increasing taxes or restrictions on business could alter conditions that directly or indirectly affect terms of credit and market opportunities.

A change in regime can also affect international investors' and currency speculators' views of a country's economic future, causing major fluctuations in the currency markets. Regime change can cause currency to lose value as it did in the summer of 1981 when socialist Francois Mitterrand won the French presidential election, or it can produce an increase in value as when conservative Edward Seaga replaced socialist Michael Manley in Jamaica. In some cases, the increase or decrease in the value of the currency that results from such perceptions and speculation is temporary, while in others it has a long-term effect.

Different regimes can also change the ability of an exporter to market his product in the host country. New regimes are often inclined to be more protectionist than their predecessors. The Labor government, elected in 1982 in Australia, tried to protect jobs through higher tariffs and import restrictions. A government may decide to create regulations aimed at reducing export opportunities from a particular country. The government of Prime Minister Mahathir in Malaysia did this in the early 1980s. The Prime Minister curtailed government purchases from British suppliers -- the "buy British last" policy. His reasons were that British businesses refused to establish scholarships to offset tuition costs for Malaysian students in

Britain and that the British government sought to curb Malaysian purchases of controlling interests in British companies. A change in regime may also mean that sales agents, once successful in marketing their product, no longer have the favor of the government. If the Marcos regime were to be replaced by a new elite, exporters to the Philippines will find themselves scrambling for new contacts.

B. Political Turmoil

Political turmoil is any business or financial disruption through violent or illegal actions resulting from politically motivated activities. It ranges in intensity and destructiveness from peaceful demonstrations, a general strike, wildcat or violent strike activity, and violent demonstrations to riots, terrorist activities, guerrilla actions, civil war, and international war.

Some political systems have learned to live with prolonged, low-level political turmoil so that the disruption of commercial activity is minimal. For example, Italy's continuing terrorist activities have caused only slight disruptions in commercial activity. In other systems, political turmoil damages the economic system and leads to a breakdown in law and order. Turkey, before the generals took over in September 1980, was plagued with killings by both the right and the left wing which led to a weakened economic position.

Political turmoil should be considered by risk analysts both for its indirect and direct effects. A buyer's business may be physically damaged during an outbreak of violence; but the more likely risk is from the deterioration of the economy and the legal and administrative processes necessary to carry on international trade. When political turmoil threatens the life and property of commercial leaders, this produces sustained capital flight, which in turn weakens the currency and could ultimately lead, as it did in Turkey, to prohibitions against the transfer of currency. The lawlessness and corruption that accompanies extensive political turmoil also hinders the ability of the government to implement the routine procedures required for currency exchange, trade licensing, and orderly customs procedures. On occasion, political turmoil can be directed explicitly at foreign citizens. The most widespread problem is the kidnapping of high-level officials, usually done by extremist groups to gain publicity and raise money to buy weapons.

C. Government Restrictions

Restrictive government policies are a less spectacular form of risk and are therefore overlooked by the mass media. But they may be potentially more devastating to foreigners than either regime change or political turmoil.

Governments restrict foreign businesses and trade for two relatively distinct reasons -- economic and ideological. Economic reasons include attempts to increase revenues, protect domestic business or jobs, maintain control over natural resources, and protect the value of the currency. Ideological reasons arise from both nationalistic and anti-capitalist sentiment in which foreign trade may be viewed as a threat not only to the economy but to the social and political values of the society. In recent years, the motive for restrictions has been more economic than ideological.

Regardless of motivation, the fact remains that governments frequently change the international economic rules of the game. Rule changes can be grouped into three categories. First, tariff levels are altered in accordance with the economic needs of the government and its attitude toward protection of local producers. Countries with chronic balance of payment deficits are likely to have high tariffs, at least on luxury goods, to keep the middle and upper classes from sending too much money out of the country in search of jewelry, high-priced automobiles, furniture, and designer clothing. If deficits reach crisis proportions, governments may also raise tariffs on consumer goods generally. However, more often than not, they opt for a second type of restriction -- non-tariff barriers. Such restrictions as prohibiting the importation of certain goods or establishing import quotas are implemented. Import licensing regulations can be changed or, as is more often the case, the administration of them can be tightened and processing slowed. Product standards can also be used as they are in Japan. A third area of rule changes is official interference in the transfer of currency. Countries with weak balance of payments positions frequently require approval of the central bank for the release of currency. Actions sometimes result in payment delays of several months and, in the case of Turkey in the late 1970s and early 1980s, years.

In addition to these types of regulations, government policies toward smuggling, corruption, and administrative efficiency can also be extremely important. Cameroon has not done much about smuggling from Nigeria, in part because it lacks the capability, but also because the northern businessmen of Cameroon profit from the smuggling at the expense of southern businessmen. A government more receptive to pressures from the south of the country could undertake a crackdown which in turn would significantly change import patterns of both Cameroon and Nigeria. Corruption in Egypt, at least until Mubarak's anti-corruption campaign, was a major source of import demand for luxury goods. Mubarak's attempt to streamline the bureaucracy to make the importing process less cumbersome will also affect exporters to Egypt. Black-market activities in goods and currencies grow out of government policies and their inability to implement them. They also play a major role in the climate for foreign business.

Governments also change the rules against foreign businesses operating in their country. One set of rules has to do with foreign ownership. In many countries, foreigners can own only a minority share of the business. Other countries permit 100% ownership by foreigners but not in all sectors. Communications and defense equipment are frequently off limits to foreign investors. Governments also place regulations on corporations concerning how many non-nationals or expatriates they can employ, where they can buy the raw material they use in manufacturing, and what kinds of products they can produce. Also governments may provide tax breaks to foreign corporations in order to attract their investments. They may also tax the profits of foreign countries or in some cases prohibit foreign companies from sending profits back home. Companies learn to live with these rules and regulations. However, the most critical concern is what are the chances that the rules will change. Companies can adjust to existing restrictions but the real problem is how to protect their investment from changes in government policies.

D. Economic Policies

Underlying governmental restrictions and ultimately political stability are the economic policies of a government. The danger signal in this regard is a pattern of economic policies that creates inflation, usually characterized by deficit spending and heavy international borrowing. Governments may pursue this pattern for a number of reasons, including:

1. Poor economic management either because officials do not understand the requirements to maintain a healthy currency or because they are unable to implement their goal.

2. Insufficient economic capability as a result of

heavy import needs of food or energy. Some countries like Egypt and Zambia lack the natural resources or economic infrastructure necessary to generate enough exports to pay for their basic import needs.

3. Lack of political will to control expenditures, especially in a country where political forces are so fractionalized that no strong government can come to power. Even such democratic countries as Belgium and Italy suffer from this problem. Unable to elect a parliament that will produce a strong government, these two countries are plagued with a series of unstable coalition governments made even weaker if strong action is seriously contemplated. They find it difficult if not impossible to pursue sound fiscal and monetary policies.

4. Political temptation to overspend occurs when governments pursue policies they know will lead to economic disaster. Governments undertake heavy welfare expenditures or subsidies for consumer needs to maintain political support. To some extent, this occurs in every country regardless of the political or economic system. But it can have disastrous results, as in Poland and Zaire.

While overspending can lead to a weakened currency and payment difficulties, as well as a currency risk for exporters, a policy of under-spending can lead to a reduction in market size and the risk of non-payment by importers who are threatened with bankruptcy. In cases where the government imposes austerity measures to correct previous policies of overspending, the exporter to the country is faced with an economy beset by low growth and high unemployment. As the economy slows, the demand for imports recedes and ultimately the government might implement protective measures to stem the growing tide of unemployment. Many countries, including the United States, have gone through such a cycle in the early 1980s.

EXERCISE 1: Select a business or government client that has economic or political interests in a particular country and list how regime change, political turmoil, governmental restrictions, and economic policies might, in any given country, harm those interests. Be as specific as possible.

CHAPTER II: GUIDELINES FOR A GENERAL COUNTRY STUDY

This chapter provides a set of guidelines that constitutes a systematic analysis of the political risks within a country. The guidelines are designed for beginning political risk analysts who are preparing a general country report. The guidelines provided are quite detailed; answering them completely would require extensive knowledge and research. However, you should be able to provide some preliminary answers to the questions by consulting almanacs, other general reference works, reading newspapers, and interviewing knowledgeable observers. The guidelines are presented in outline form and are designed as an eighteen-month forecast. The time limit could be easily expanded, however, depending on the purposes of the political analysis. The guidelines could also be easily adapted to projects of specific study.

I. Background

A. Discuss background factors that have the most significant impact on the way the political system works:

   1. Geographic factors, including (as appropriate) location, natural resources, topography.

   2. International political factors (such as relationships with neighbors and others in its region), involvement in major power conflicts, territorial disputes, alliances.

   3. Social problems, including (as appropriate) ethnic or racial conflict, inequality, regional differences, urban-rural conflict.

   4. Economic problems, including (as appropriate) growth, inflation, unemployment, international finance and trade.

B. Describe the most important sources of political power within the system.

C. Discuss the general orientation of the present government and other political groups toward private enterprise, both domestic and foreign. Write one paragraph each on 1) the orientation of the government and influential actors toward both domestic private enterprise and foreign investment, 2) labor conditions, and 3) the degree to which government bureaucracy hinders or aids the conduct of business.

D. On separate paper, list and briefly describe up to four of the most important political issues which will affect political stability, economic conditions, or policies toward international business. A "political issue" is defined as a controversial public decision -- either a new policy or changing existing policy -- and can include major political questions (e.g., return to civilian rule or regional autonomy), economic decisions (e.g., denationalizing banks, deficit spending, or indexing wages to inflation), international policy (e.g., joining the EEC), or policies directly affecting international business (e.g., establishing natural gas prices or devaluation). In a single paragraph for each issue: 1) briefly state the issue, 2) estimate its likely outcome, and 3) describe what its impact would be if it is carried out. These issues may be discussed further in other sections of the report. The purpose here is to highlight them and to provide background so when they are raised in connection with regime control, political turmoil, and restrictions on business and trade, they need not be described in detail again.

II. Political Actors

This section provides information about the most important individuals, groups, and institutions which affect regime stability, political turmoil, restrictions on international business, trade policy, and economic policy.

A. For each group, organization, institution, or agency:

1. Size, membership, and background.

2. Source of support and/or authority.

3. Current allies and/or opponents.

4. Role in supporting or opposing the current regime.

5. Role in promoting political stability or turmoil.

6. Role in policies or attitudes toward business generally both domestic and foreign.

B. For each individual:

1. Personal characteristics, including background, health, and style of behavior.

2. Source of support and/or authority.

3. Current allies and/or opponents.

4. Role in supporting or opposing the current regime.

5. Role in promoting political stability or turmoil.

6. Role in policies or attitudes toward business generally, both domestic and foreign.

III. Regime Stability

This section identifies the most likely, second most likely, and third most likely alternative regimes to be in power eighteen months from now. The three alternatives should be identified and discussed in the order of likelihood. In selecting the three, one of the choices may be a continuation of the existing regime, which will typically, though not necessarily, be the most likely.

The selection of the three alternatives may also raise some questions concerning what constitutes "different" regimes. One regime is different from another if it has different key personnel in top policymaking positions. The difference can be a result of a purge, election, coup d'etat, reorganizations, or high-level resignations. Changes in minor cabinet positions should not be considered in a different regime. If two or more regimes are tied for third most likely, choose the regime that is most likely to produce different policies than either the first or second most likely alternative.

A. Identify and forecast the most likely regime. Discuss the role of supporting and opposing actors. Indicate the degree to which background factors such as economic performance, social conditions, or international events might affect the support for, and opposition to, this regime, and the likelihood of this regime being in power eighteen months from now.

B. Discuss the second most likely regime at the end of the next eighteen months. Describe under what conditions it might come into power. Indicate whether this regime will lead to major shifts in policies or will have a minor impact.

C. Discuss the third most likely regime. Make sure it is substantially different from the other two. Describe under what conditions it might come into power. Indicate whether this regime will lead to major shifts in policies or will have a minor impact.

IV. Political Turmoil

This section forecasts the types and magnitude of politically motivated violence in the next eighteen months. Political turmoil includes general strikes, demonstrations, riots, terrorism, guerrilla activities, and civil and international war.

A. Describe the recent pattern of political turmoil and how it has affected society. Include both domestic and international sources of violence.

B. Forecast the magnitude and type of turmoil likely to occur over the next eighteen months under the most likely regime. Describe the actors and their capability to cause or deter turmoil. Discuss the impact of turmoil, including 1) the direct impact in which international interests serve as a target of turmoil, and 2) the indirect impact from disruptions in communications, transportation, labor supply, economic stability, and capital flight.

C. Forecast of turmoil under the second most likely regime.

D. Forecast of turmoil under the third most likely regime.

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V. Restrictions on International Business

This section forecasts the likelihood that in the next eighteen months the government will change restrictions on the operations of international business through restrictions on ownership, management, labor policies, local operations, and the repatriation of profit or capital.

A. Describe the configuration of key political actors respecting general support for, or opposition to, restrictions on international business under the most likely regime. Also indicate what changes in the political configuration might occur under the second and third alternatives described in the regime stability section. Discuss other factors, such as economic changes or international conflict, which might alter the present configuration.

B. Forecasts of changes in restrictions:

1. Restrictions on foreign equity ownership

    a. Current levels?

    b. Future policy under most likely regime?

    c. Future policy under second most likely?

    d. Future policy under third most likely?

2. Requirements for personnel and procurement

    a. Current informal and formal restrictions on procurement, on using expatriates for management, labor, other?

    b. Future policy under most likely regime?

    c. Future policy under second most likely?

    d. Future policy under third most likely?

3. Taxation discrimination

    a. Taxation discrimination for and against foreign business

    b. Future policy under most likely regime?

    c. Future policy under second most likely?

d. Future policy under third most likely?

4. Restriction on repatriation of capital and profits

   a. Current restrictions?

   b. Future policy under most likely regime?

   c. Future policy under second most likely?

   d. Future policy under third most likely?

5. Exchange controls

   a. Current policy?

   b. Future policy under most likely regime?

   c. Future policy under second most likely?

   d. Future policy under third most likely?

VI. Trade Policies

This section forecasts the likelihood that in the next eighteen months the government will significantly change policies restricting imports.

A. Describe the configuration of key political actors on the policies restricting imports under the most likely regime. Indicate what changes in support or opposition to existing policies might occur under the other two alternatives discussed in the regime stability section. Discuss what other conditions, such as current accounts difficulties, might alter the present configuration.

B. Forecasts of changes in tariffs and non-tariff barriers:

1. Tariffs

   a. Current levels?

   b. Future policy under most likely regime?

   c. Future policy under second most likely?

   d. Future policy under third most likely?

2. Non-tariff barriers
    a. Current levels?
    b. Future policy under most likely regime?
    c. Future policy under second most likely?
    d. Future policy under third most likely?

VII. Economic Policies

A. Fiscal and monetary policy - Describe current government fiscal and monetary policies with respect to deficit spending, control over credit, and other stimulants to economic growth and limitations on inflation:

1. Future policy under most likely regime?
2. Future policy under second most likely regime?
3. Future policy under third most likely regime?

B. Labor Policy - Describe policies that directly and indirectly affect labor costs. Such policies include, but are not limited to, minimum wage legislation, benefit requirements, and constraints on the power of labor organizations:

1. Future policy under most likely regime?
2. Future policy under second most likely regime?
3. Future policy under third most likely regime?

C. Policies toward international finance - Describe the current policies of the government with respect to obtaining short-term and long-term capital from external sources. Include policies toward international financial institutions (such as the IMF and the World Bank), private sources, and other special sources (such as foreign aid):

1. Future policy under most likely regime?
2. Future policy under second most likely regime?
3. Future policy under third most likely regime?

EXERCISE 2: For a country you have chosen, answer the questions provided above.

CHAPTER III: MAKING POLITICAL FORECASTS WITH THE PRINCE SYSTEM

From Chapter II, it should be obvious that the most critical and difficult task required by the questions is to make political forecasts. Forecasts about what regime is likely to be in power play a major role in the entire analysis of what political conditions will affect international business. It is also necessary to make forecasts about political turmoil, restrictions on international business, and international trade. For that reason, we have included in this chapter an introduction to the Prince system. A more complete explanation can be obtained from PS-23, Political Analysis through the Prince System. The next few pages contain instructions for using the Prince system, reproduced by permission from Frost & Sullivan, Inc., New York.

The Prince Model: Probabilities and Decision Structure Charts

A unique feature of the Country Reports in World Political Risk Forecasts (WPRF) is the political analysis conducted on a systematic and uniform basis. The framework is used in the Country Reports to generate probability scores for the most likely regime and for political turmoil, restrictions on international business, and trade restrictions. It is also used to construct the Decision Structure Charts that illustrate the political forces underlying these probabilities. Readers can also conduct their own analysis with this framework in order to supplement and complement WPRF's forecasts. This section describes and explains how the Prince Model is used to generate probabilities and how to interpret the Decision Structure Charts that are derived from the Prince calculations.

The Prince Model has been developed by the editors of WPRF, William D. Coplin and Michael K. O'Leary, and is described in their book, Everyman's PRINCE: A Guide to Understanding Your Political Problems (North Scituate, Mass.: Duxbury Publishing Company, 1976. Revised Edition).

A general political forecasting model that can be applied to any collective action, the Prince Model has evolved over many years of refinement and application. It is useful in a wide variety of political situations, and is one of the few approaches to political forecasting that is both systematic and relevant to decision-makers. The model provides a means for the rigorous analysis of information, producing calculations that result in forecasts of the probability of specific political outcomes. At the same time, it uses the invaluable and unique expertise of specialists -- both to supply information for the model and to adjust the calculations produced by the model according to qualitative, subjective knowledge about a given country.

The Prince Model has also been applied to areas other than political risk analysis by Coplin and O'Leary. In 1972, it assisted the Intelligence and Research Bureau of the Department of State in forecasting the probability of a successful agreement between North and South Korea concerning an agenda of outstanding issues. The model assisted the U. S. Army Corps of Engineers in estimating the likelihood of decisions affecting wetlands regulatory policy in the mid-1970s. More recently, it aided the Central Intelligence Agency in estimating the probable position of 52 countries on various issues at the 1979 World Administrative Radio Conference. The model has also been used by several local government agencies in forecasting political events.* Because of its

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*) Publications by William D. Coplin and Michael K. O'Leary describing application of the Prince Model (in order of publication date):

"Policy Profiling Army Corps Decisions." Syracuse, N.Y.: Syracuse Research Corporation, 1979.
"Urban Forestry Programs: Analysis and Recommendations." Syracuse, N.Y.: Syracuse Research Corporation, 1979.
"Testing Two Methods of Short Term Forecasting of Political Violence." _Technological Forecasting and Social Change_, Vol. 14, No. 2. New York: American Elsevier Publishing Company, 1979.
"The 1979 World Administrative Radio Conference. Briefing Manual for Issue Analysis." Syracuse, N.Y.: Syracuse Research Corporation, 1978.
Everyman's PRINCE: A Guide to Understanding Your Political Problems. Rev. ed. North Scituate, Mass.: Duxbury Publishing Company, 1976.

(Continued on next page)

general forecasting applicability, the Prince Model can be applied to any of the numerous collective actions which shape the political risks facing multinational corporations.

A. Prince Charts

In order to obtain information for a country forecast, the first step in using the Prince Model is to conduct a survey of the team of expert analysts (at least three for each country). Each team member answers a questionnaire that includes several "Prince Charts," which are used to record the positions of major individuals, groups, and institutions on a particular action that could affect international business in the country. In completing the charts, experts are first asked to list at least seven actors that are able to influence each action during the next eighteen months. The actors selected may be individuals, groups or ministries within the government, opponents of the government, or groups in the society, such as business, unions, or ethnic organizations. Actors may also include foreign individuals or institutions, such as the International Monetary Fund or other governments.

The experts then indicate on the Prince Chart their estimates of the position of each actor listed, according to the four categories listed on the next page.

Towards the Improvement of Foreign Service Reporting. (Based on a Report to the [Murphy] Commission to Study the Organization of the Government in the Conduct of Foreign Policy.) Washington, D.C.: U.S. Government Printing Office, 1975.

Quantitative Techniques in Foreign Policy Forecasting and Analysis. New York: Praeger, 1975.

"Quest for Relevance: Quantitative International Relations Research and Government Foreign Affairs Analysis." International Studies Quarterly, Vol 18 (June 1974).

"The PRINCE Concepts and the Study of Foreign Policy," in Patrick McGowan, ed., The Sage International Yearbook of Foreign Policy Studies. Beverly Hills, Calif.: Sage Publications, 1974.

1. Orientation - The current general attitude of the actor toward the action. The actor's orientation is classified into one of three categories: Support (S), Neutrality (N), or Opposition (O).

2. Certainty - The firmness of the actor's orientation. For group actors, certainty is a function of the extent to which there is consensus among the actor's membership in supporting or opposing the action. Certainty is measured on a scale ranging from 1 (little or no certainty) to 5 (extremely high certainty).

3. Power - The degree to which the actor can exert influence, directly or indirectly, in support of or in opposition to the action relative to all other actors. The bases of an actor's power, as well as the ways in which this power may be exercised, are varied. Power may be based on such factors as group size, wealth, physical resources, institutional authority, prestige, and political skill. Power is measured on a scale ranging from 1 (little or no power) to 5 (extremely high power).

4. Salience - The importance the actor attached to supporting or opposing the action relative to all other actions with which that actor is concerned. Salience is measured on a scale ranging from 1 (little or no importance) to 5 (extremely high importance).

The Prince Charts obtained from each of the team members are analyzed to measure the degree of consensus among the experts. If the team members differ significantly on estimates of an actor's position, additional information is sought. After obtaining a clear consensus among the experts, the individual charts are then combined into a single set of estimates. Figure 1 (following page) is an example of a Prince Chart showing the combined judgment of the experts on the positions of actors supporting and opposing the Marcos regime in the Philippines in June 1980, when it was compiled before the assassination of Benigno Aquino.

B. Decision Structure Charts

The information in the Prince Chart, which represents a consensus of experts' estimates, is used to create a Decision Structure Chart for each risk factor. Decision Structure Charts visually portray the forces supporting and opposing

Figure 1

PRINCE CHART: THE CONTINUATION OF THE MARCOS REGIME (JUNE 1, 1980)

CURRENT ESTIMATES

ORIENTATION	CERTAINTY, POWER, SALIENCE	
+ Supports	1 Little/None	4 High
O Neutral	2 Slight	5 Extremely High
— Opposes	3 Moderate	

ACTOR	ORIENTATION	CERTAINTY	POWER	SALIENCE	PRINCE SCORE
Benigno Aquino	—	x 5	x 2	x 5	: −50
Armed Forces	+	x 4	x 3	x 4	: +48
Cardinal Sin	−	x 5	x 1	x 5	: −25
Christian Left	−	x 5	x 1	x 3	: −15
Economic Elite	+	x 4	x 3	x 2	: +24
Moderate Opposition	−	x 2	x 2	x 3	: −12
Labor	−	x 3	x 1	x 3	: −9
Raul S. Manglapus	−	x 5	x 1	x 3	: −15
Ferdinand Marcos	+	x 5	x 5	x 5	: +125
Moro National Liberation Front	−	x 3	x 2	x 2	: −12
New People's Army	−	x 5	x 2	x 2	: −20
Cabinet	+	x 5	x 2	x 4	: +40
Overseas Opposition	−	x 2	x 1	x 3	= −6

each factor, presenting an overall picture of the probable action concerning the factor.

On the chart, each actor is placed along the vertical axis according to whether it supports, is neutral toward, or opposes the action, and by the certainty of the actor's support or opposition. The actors are located along the horizontal axis according to their importance in determining the outcome of a decision as measured by their power (ability to influence the decision) and salience (the likelihood that an actor will use its power to influence the decision). Thus, the position of the actors in relation to the two axes indicates their roles in determining the action.

Actors located in the upper right corner of the chart are those that exert the maximum weight in support of the action. Actors in the lower right corner of the chart are those that exert the maximum weight against the action. Actors located in the middle of the vertical axis are either undecided or likely to shift positions. Actors located in the upper left are strong supporters of the action, but carry little weight in determining its outcome. Actors in the lower left are opponents with little influence.

Figure 2 (next page) is the Decision Structure Chart based on the Prince Chart for the Philippines (Figure 1). The two charts show significant differences among the actors in the Philippines concerning a regime change. One extreme position is that of Ferdinand Marcos, located in the upper right corner of the Decision Structure Chart, not only adamantly in support of his regime but also having the capability to exert maximum weight to support his orientation. A different extreme position is that of Raul S. Manglapus, located in the lower left corner of the Decision Structure Chart, opposed to the regime, yet with little ability to bring about change.

The political analysis underlying WPRF's forecasts can best be understood by examining the Decision Structure Chart in conjunction with the narrative analysis provided for each estimate. The narrative appearing with the chart describes the factors underlying the positions and the importance of the actors, possible coalition changes, other actors that may become important, and the impact of the changes on international business.

While each Decision Structure Chart is unique in many respects, certain general patterns frequently appear. The end of this chapter includes examples of typical patterns. Note that in three of the four illustrative charts (charts B-D), the probability of the action's occurrence is low.

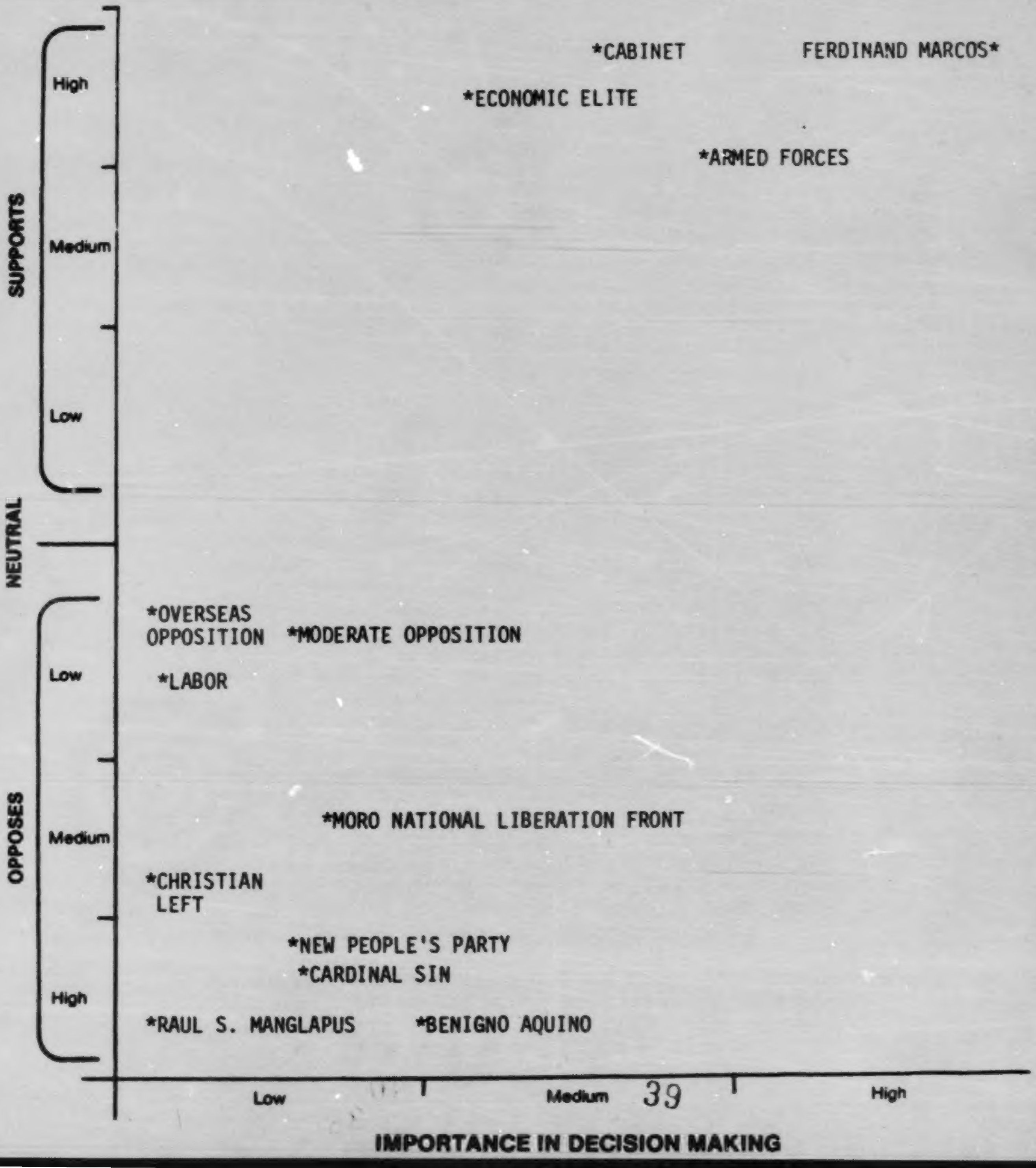
Figure 2

DECISION STRUCTURE

THE CONTINUATION OF THE MARCOS REGIME

Country PHILIPPINES

Date June 1980



However, each of these three charts presents patterns of actor distributions that indicate quite different interpretations of the forecasts about the outcome. A summary analysis is provided with each of the four charts.

C. Probability Calculations

The estimates of the probability of the occurrence of an action in the next eighteen months come from the country specialists' analyses of the actors' positions. Each actor is assigned a total score in each Prince Chart. This "Prince Score" is the product of the firmness of the actor's orientation to the action (certainty), the actor's ability to influence the outcome of the action (power), and the importance of the action to the actor (salience). The score has a positive sign if the actor supports the action and a negative sign if the actor opposes the action. Figure 3 (next page) presents these actor-by-actor scores for support of the Marcos regime.

The major opponent of the regime, Benigno Aquino, is assigned a total of -50, while Ferdinand Marcos is assigned a total score of +125. These scores reflect the actors' opposition or support for the regime and also their respective importance in either opposing or supporting the regime. This Prince Chart indicates that Ferdinand Marcos' ability to support his regime is stronger than Benigno Aquino's ability to help bring about a regime change.

The chart also shows the large number of opponents of the Marcos regime. The ability of these opponents, each relatively weak, to coalesce and increase their strength is what constitutes a danger to the regime. The text accompanying the probability forecast discusses the factors that might result in such coalitions.

The Prince Chart numbers provide the basis of a formal estimate of the probability of an action's occurrence. This probability is defined as ΣW_s divided by ΣW_t. W_s is each of the positive Prince Scores. W_t is the absolute value (ignoring the minus signs) of each actor's Prince Score. In order to arrive at a probability score for an action, the absolute values of all the actor scores are added to produce a number representing the total weight in the political system that could influence the action's occurrence (ΣW_t). This number is divided into the sum of the positive scores, which represents the total weight in support of the action (ΣW_s). The resulting fraction is the probability score. The greater the weight of actors supporting an action relative to all

Figure 3

PRINCE CHART: THE CONTINUATION OF THE MARCOS REGIME (June 1, 1980)

CURRENT ESTIMATES

ORIENTATION

+ Supports
0 Neutral
− Opposes

CERTAINTY, POWER, SALIENCE

1 Little/None
2 Slight
3 Moderate
4 High
5 Extremely High

ACTOR	ORIENTATION	CERTAINTY	POWER	SALIENCE	PRINCE SCORE
Benigno Aquino	−	x 5	x 2	x 5	= −50
Armed Forces	+	x 4	x 3	x 4	= +48
Cardinal Sin	−	x 5	x 1	x 5	= −25
Christian Left	−	x 5	x 1	x 3	= −15
Economic Elite	+	x 4	x 3	x 2	= +24
Moderate Opposition	−	x 2	x 2	x 3	= −12
Labor	−	x 3	x 1	x 3	= −9
Raul S. Manglapus	−	x 5	x 1	x 3	= −15
Ferdinand Marcos	+	x 5	x 5	x 5	= +125
Moro National Liberation Front	−	x 3	x 2	x 2	= −12
New People's Army	−	x 5	x 2	x 2	= −20
Cabinet	+	x 5	x 2	x 4	= +40
Overseas Opposition	−	x 2	x 1	x 3	= −6

PROBABILITY EQUATION:

$$\frac{\Sigma W_s}{\Sigma W_t} = \frac{\text{Sum of Total Positive Actor Scores (Including 1/2 of each Neutral Actor Score)}}{\text{Sum of Absolute Value of All Actor Scores (Including Neutral Actors)}} = \frac{237}{401}$$

Probability = 59%

weight in the system (as defined by the Prince Chart), the higher the probability of the action's occurrence.

If an actor is neutral toward the action, its potential score (the product of power, salience, and certainty) is added to the sum of the absolute values of all the other scores (the denominator in the probability equation, ΣW_t). Half of the neutral actor's score is added to the sum of the scores in support of the action (the numerator in the probability equation, ΣW_s). Adding only half the neutral actor's score to the numerator is based on the assumption that there is an even chance that the actor will eventually either support or oppose the action.

As Figure 3 shows, in the Philippine example the total weight in the political system affecting the support for the regime was 401. This is the denominator in the probability equation. The numerator in the probability equation, the sum of the positive actor scores, was 237. The quotient, the probability of the Marcos regime's remaining in power for the next eighteen months (following June 1980) was 59%. As will be described in the next section, the model can be applied to forecasting the likelihood of regime stability, political turmoil, restrictions on international business, and trade restrictions.

D. Using the Prince Model

The Prince Model is applied in several ways throughout the WPRF Country Reports. A sample Country Report on Egypt appears as Appendix II at the end of the learning package. The probability of the most likely regime in the eighteen-month forecast appears in the [executive] summary (page EX-2) and in the section on regime stability (page C-1). A Decision Structure Chart is also included in that section (page C-3). Furthermore, Decision Structure Charts on political turmoil, restrictions on international business, and trade restrictions appear in the report's respective sections. Finally, the probabilities calculated according to the Prince Model appear on page B-1 of the report. That page summarizes the influence of each actor on the three conditions by reporting both the actors' Prince Scores and the resulting probability calculation.

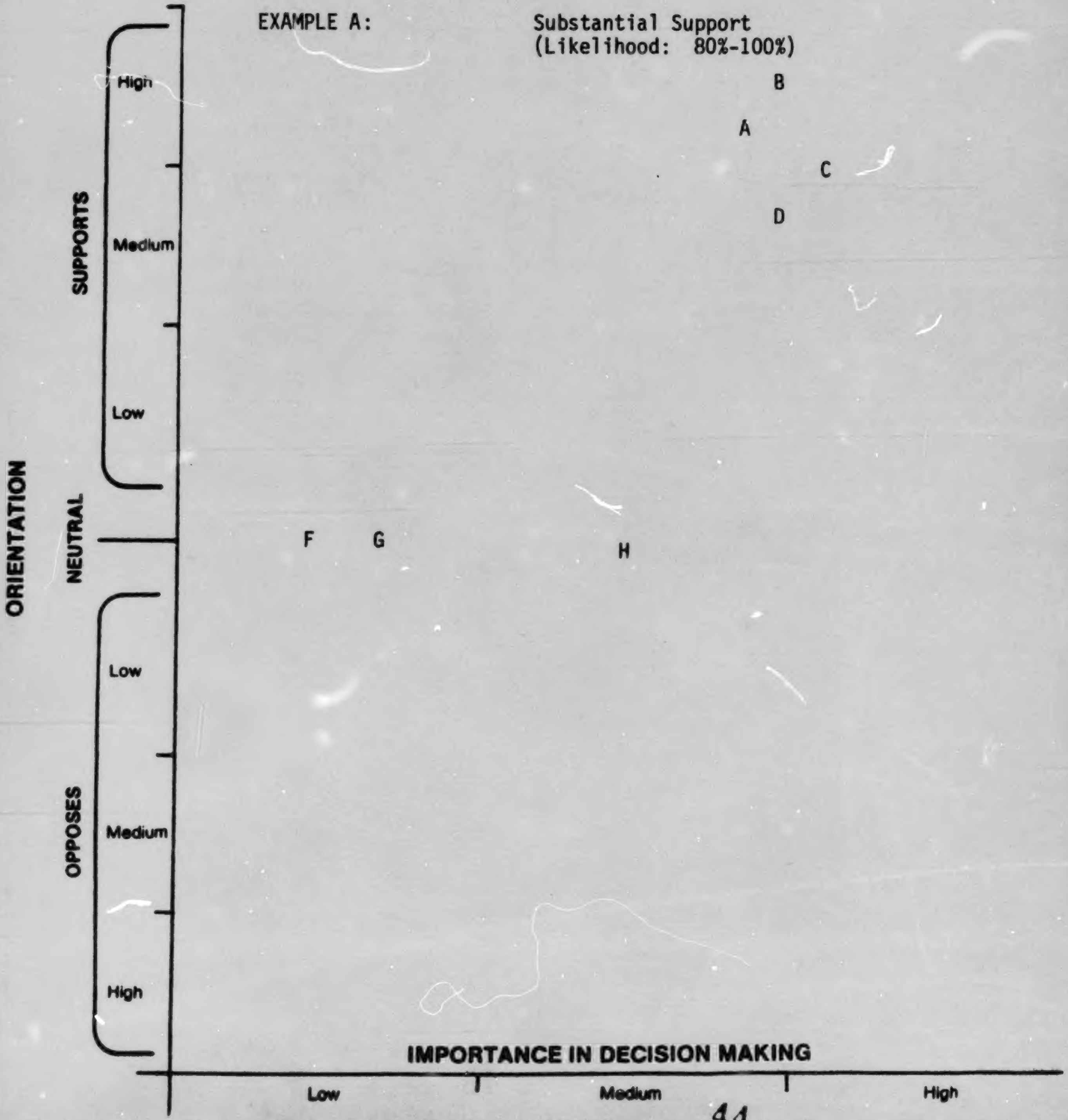
Because the Prince Model is generic, it can be applied as a framework for analyzing other political decisions that may affect a business project. Some users of WPRF have their field staff complete Prince Charts, either for routine monitoring or for analyzing specific decisions. In addition to being used by individual analysts to complete a Prince analysis on their own, the Prince framework can be used in planning or decision meetings in which members of the group share their knowledge about political conditions.

To assist users in applying the Prince Model for their special needs, a blank Prince Chart appears in Exercise 3. The first step is to settle on a specific decision to be predicted. The decision should be stated as a relatively specific action. Then the chart should be completed following the instructions on the preceding pages. Calculate the Prince probability and prepare a Decision Structure Chart. (A blank Decision Structure Chart is also included in Exercise 3.) The orientation and firmness variables determine the location of the actor on the vertical axis; multiplying the salience and power variables determines the location of the actor on the horizontal axis.

The following pages 28 to 31 show some of the typical types of distribution that may occur on a Decision Structure Chart. Each of these charts has a brief interpretation of the type of likely political outcome each chart portrays.

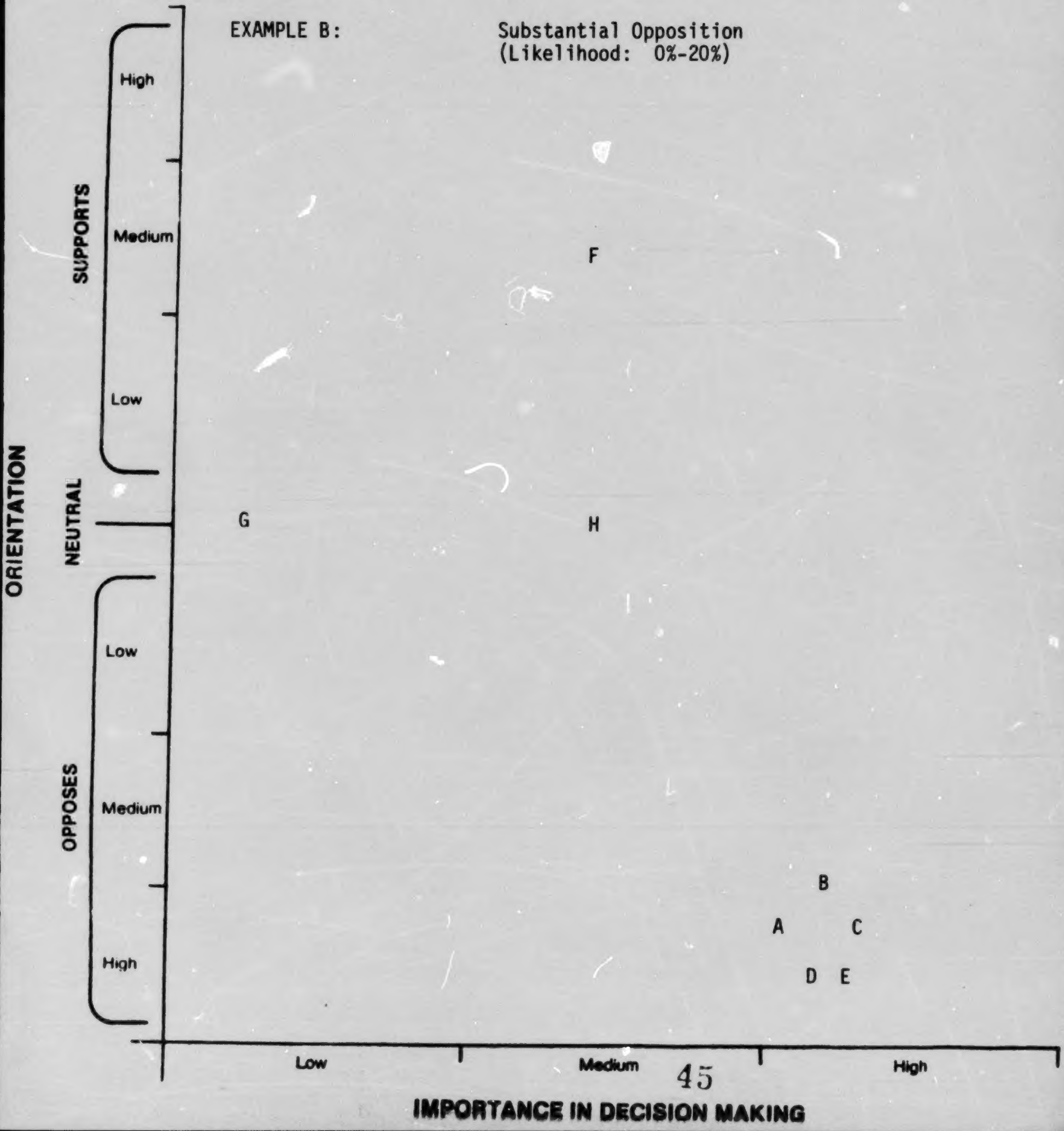
DECISION STRUCTURE CHART A

Substantial Support. Most of the actors are in the upper right-hand corner, indicating that the overwhelming weight is in favor of the outcome. A few actors are opposed; however, they possess much less weight in determining the outcome. Even if the opponents become more strongly opposed, they will not significantly change the likelihood of the outcome's occurrence.


EXAMPLE A: Substantial Support
(Likelihood: 80%-100%)

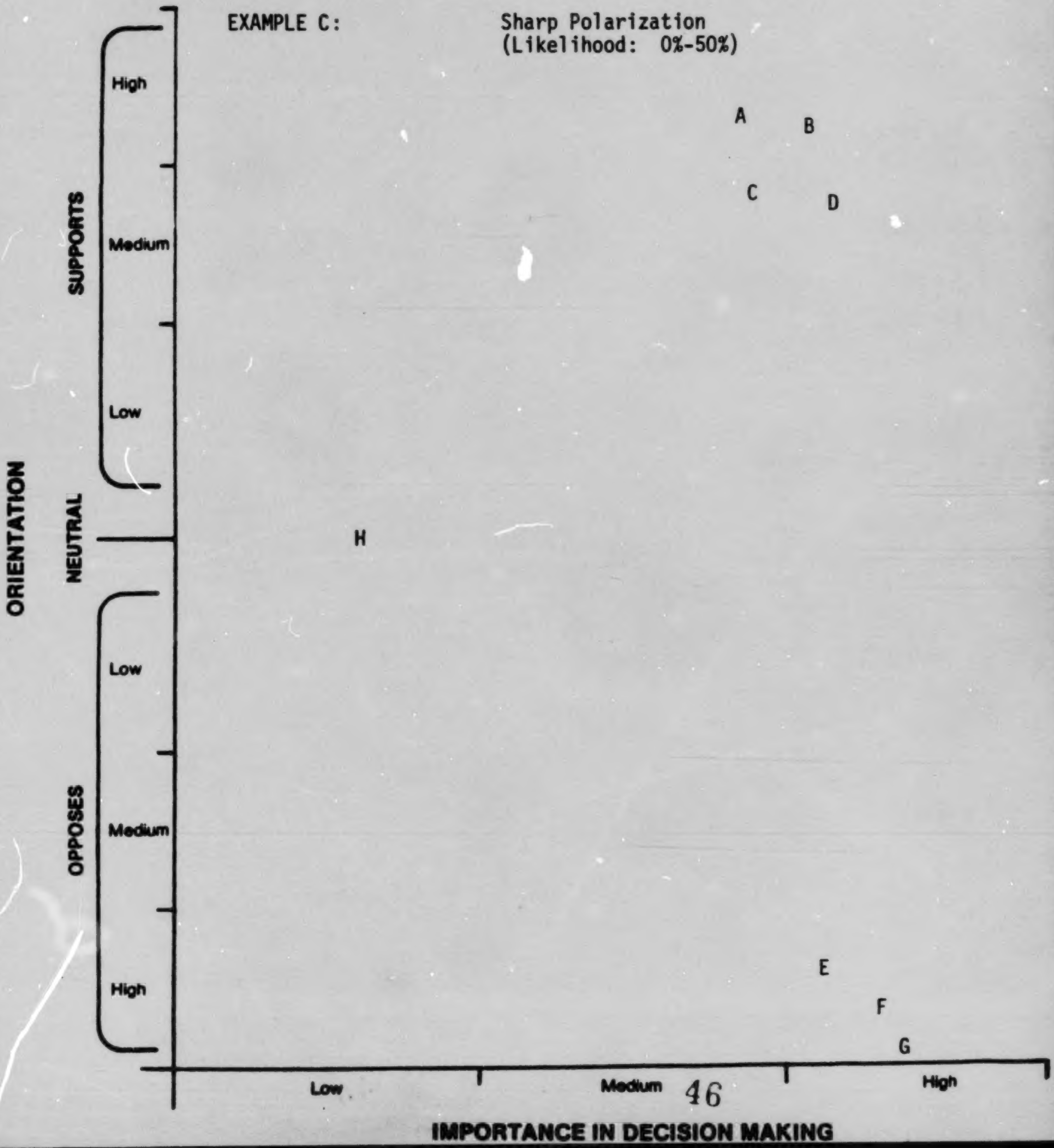
DECISION STRUCTURE CHART B

Substantial Opposition. Most of the actors are in the lower right-hand corner, indicating that the overwhelming weight is in opposition to the outcome. Even if those who are moderate in their opposition change to support, the net weight of the players will still be against the outcome's occurrence.


EXAMPLE B: Substantial Opposition
(Likelihood: 0%-20%)

DECISION STRUCTURE CHART C

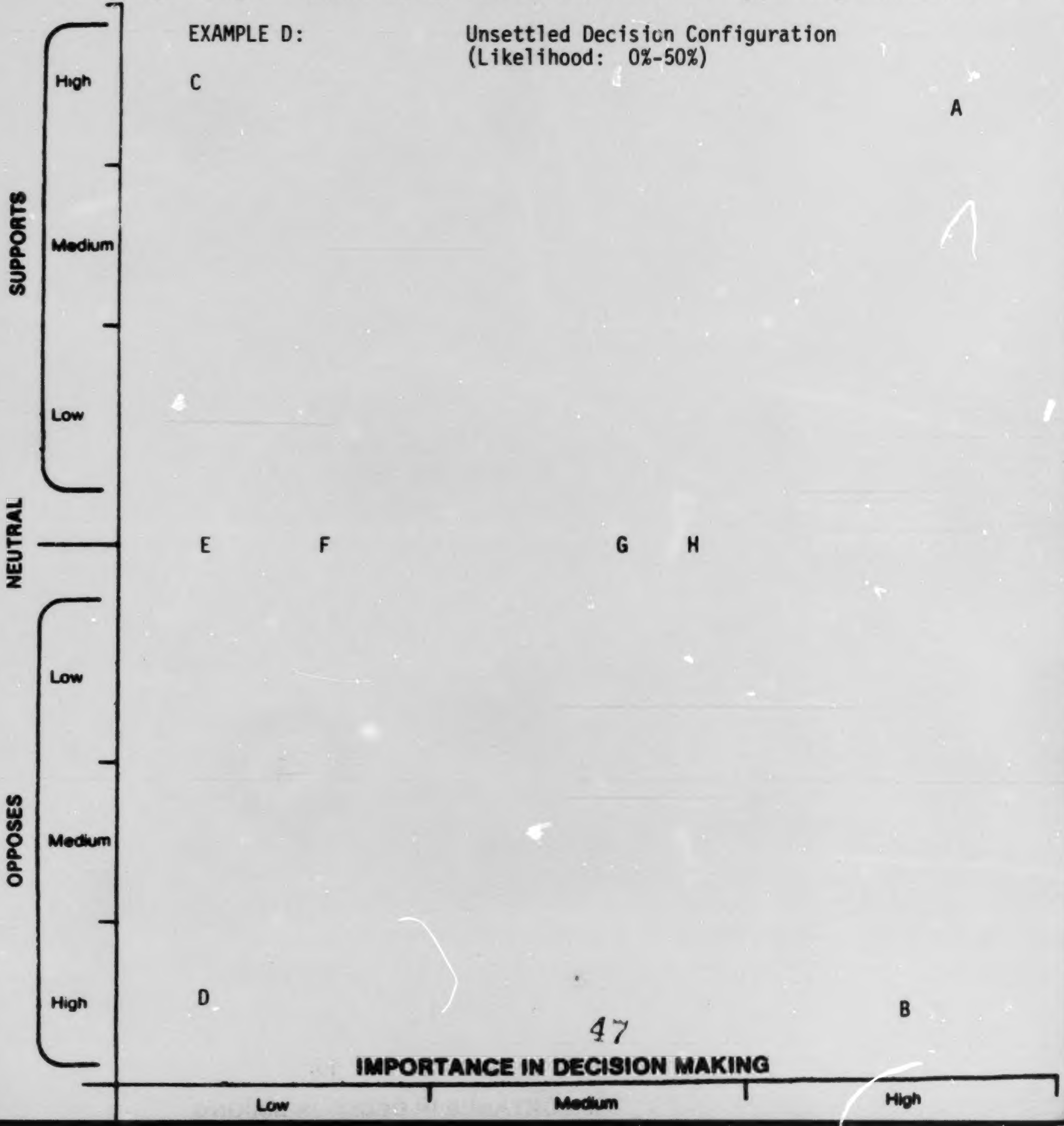
Sharp Polarization. The number and weight of the players is about evenly split between the supporters and the opponents of the outcome. The forecast in this case is that: 1) no decision will be made soon, and 2) controversy over the outcome will be high and will contribute to conflict within the country.


EXAMPLE C: Sharp Polarization (Likelihood: 0%-50%)

DECISION STRUCTURE CHART D

Unsettled Situation. A few actors strongly support the outcome and a few strongly oppose it, but the bulk of the actors are either undecided or lacking in decisive weight in determining the outcome. This is the situation in which forecasting is most difficult. The only certainty is that a positive decision will not be made soon. However, more information will have to be obtained about the impact of other issues and about the relationships among the actors before the outcome can be more precisely estimated.

EXAMPLE D: Unsettled Decision Configuration (Likelihood: 0%-50%)



EXERCISE 3: Select one political event, such as a change in regime or a regulation concerning international trade, and complete the Prince Chart and Decision Structure Chart on the following pages for that decision.

PRINCE CHART:

CURRENT ESTIMATES

ORIENTATION	CERTAINTY, POWER, SALIENCE	
+ Supports	1 Little/None	4 High
O Neutral	2 Slight	5 Extremely High
– Opposes	3 Moderate	

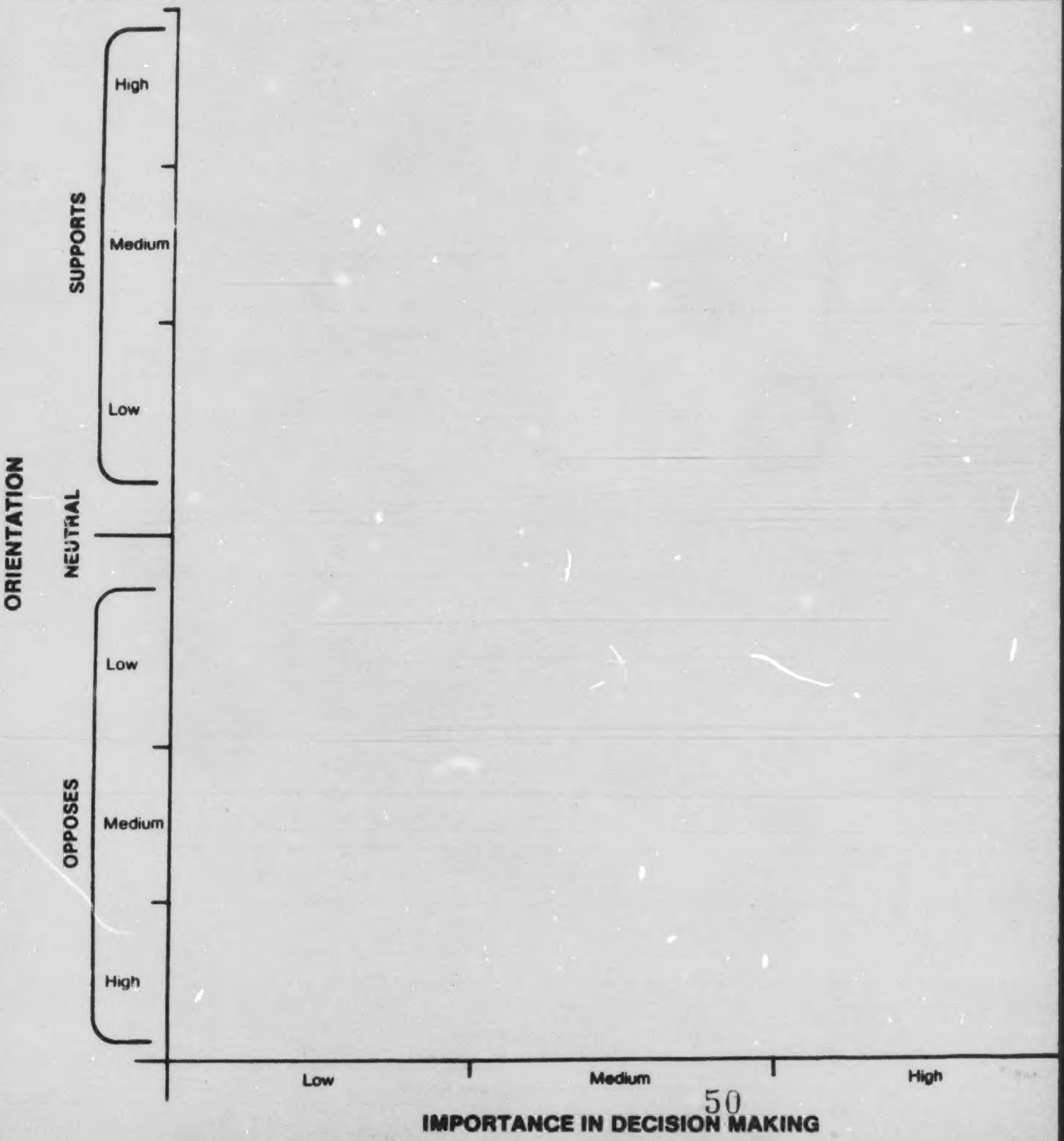
ACTOR	ORIENTATION		CERTAINTY		POWER		SALIENCE		PRINCE SCORE
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	
		×		×		×		=	

PROBABILITY EQUATION:

$$\frac{\sum W_s}{\sum W_t} = \frac{\text{Sum of Total Positive Actor Scores (Including 1/2 of each Neutral Actor Score)}}{\text{Sum of Absolute Value of All Actor Scores (Including Neutral Actors)}} = \underline{\qquad\qquad}$$

DECISION STRUCTURE

Country	
Date	



CHAPTER IV: CALCULATING A RISK RATING

In order to make comparisons across various countries, analysts frequently try to reduce their political risk calculations to a small number of numerical or letter-grade ratings. These ratings greatly oversimplify the results of the political risk analysis, but they are important because they force the analysts to standardize their conclusions so that others can judge the relative riskiness of various countries. Many of the schemes ask analysts to rate countries on a series of numerical scales (e.g., 1 to 10) and a single score is determined by taking the average of the ratings. This approach ignores essential complexities and should only be used as a last resort in most cases.

The scheme presented below was developed by the authors of this package for Frost & Sullivan's World Political Risk Forecast. It uses 60-page country studies that are produced by experts who respond to questions similar to those provided in Chapter II. The experts also complete the kinds of Prince Charts presented in Chapter III. In the discussion below, we will present the calculation procedure that takes the information from a country study and produces a letter grade for countries that ranges from A+ to D- for three categories of risk -- financial, manufacturing and extractive, and export.

A. Meaning of the Risk Indicators

Before looking at the calculation procedures, let's examine the meaning of the risk indicators. Table 1 on the following page briefly describes the ratings and business sectors or categories of risk.

The Finance category weighs government actions affecting the flow of money in and out of the country. It encompasses risks that result from poor economic conditions, in which foreign debt and currency weakness may affect the ability of the government or local businesses to pay debts in a timely fashion. This ranking summarizes the information of greatest

TABLE I: DESCRIPTION OF RISK RATINGS FOR THREE BUSINESS SECTORS

FUTURE CONDITIONS AND POLICIES

Risk Rating	Finance	Manufacturing and Extracting	Export
A+,A,A-	Favorable attitude to international business. No restrictions on exchange and payments. Prudent international financial policy.	Stable country. Favorable attitude, especially with respect to equity, loan participation, and taxes. Restraint in fiscal and labor policy.	Stable country. Tariff and other barriers to trade and payments are minimal. Prudent international borrowing policy.
B+,B,B-	Generally favorable attitude, but some selected restraints on currency flows.	Limited but possibly dangerous turmoil or moderate restrictions on business activity. Modest increase in labor cost and power.	Limited but selectively dangerous turmoil or policies restricting trade and payments.
C+,C,C-	Widespread (but restrained) pressures for restrictions on international business. Financial policies leading to questionable international debt.	Moderate to high turmoil, creating security problems. Policies focus on special controls on equity, repatriation, or other controls on foreign business. Labor policies leading to escalating labor costs.	Sufficiently high turmoil to create risks to delivery or payment. Policies restrict or increase the cost and difficulty of trade and payments. International financial policy causing declines in currency value.
D+,D,D-	Widespread hostility to foreign business. Tight controls on international payments and other transactions. Financial policies leading to excessive international debt.	Turmoil presents serious security concerns. Foreign business a handy scapegoat in politics. Severe (though sometimes inconsistent) restrictions on all phases of business operations.	Turmoil creates serious problems for the fulfillment of contracts. Inconsistent and restricted payment. Currency fluctuates widely as a result of international finance policies.

interest to WPRF's banking clients as well as to related companies, such as those in insurance and investment. Finance officers for all types of businesses also find this category highly relevant.

The Manufacturing and Extracting category weighs government actions that affect the supply of materials and labor as well as the control of equity, capital, profit, and operations. It deals with a wider range of risks than the Finance category and is of most interest to WPRF users who have current or planned overseas facilities.

The Export category weighs government actions affecting exports to the country. It deals with trade restrictions and factors affecting payment. Marketing and credit managers within exporting companies are the users who typically are most interested in this category.

It should be emphasized that the ratings apply to the sector in a general way; specific businesses even in the same sector may have different risks that would require the adjustment of the ratings. The rating of A, B, C, or D is provided to allow the reader to quickly see the overall conclusion of the country report as it pertains to the general categories of risks pertaining to each sector.

B. Calculating Risk Indicators

The letter grades are determined by taking the results of a country study and applying them to a worksheet. Table 2 (next page) provides an example of part of the summary of a study on Nigeria completed in February 1982. The summary shows the letter grade given, the three regimes thought to be in power, the current level of political turmoil, restrictions on international business, trade policy, and economic policy, as well as what it would be under each of the three regimes. Table 3 (page 39) translates those conclusions into numbers on a worksheet and then shows how the calculations produce a letter grade.

TABLE 2: SUMMARY OF EIGHTEEN-MONTH FORECAST

Risk Ratings by Sector: Finance, C+ Manufacturing/Extractive, C Export, C+

Risk Factors under Three Most Likely Regimes (with Each Regime's Likelihood)

	Current Level	Shagari Stays (80%)	UPN Regime under Awolowo (10%)	Military Takeover (10%)
Political Turmoil	Moderate	Same	MORE	MUCH MORE
Restrictions on International Business:				
I. Equity	Moderate	Same	MORE	MORE
II. Personnel/Procurement	High	Same	MORE	MUCH MORE
III. Taxation Discrimination	Moderate	MORE	MORE	MORE
IV. Repatriation	Moderate	MORE	MORE	MORE
V. Exchange Controls	High	MORE	MUCH MORE	MUCH MORE
Trade Policy:				
I. Tariffs	Moderate	Same	Same	MUCH MORE
II. Non-Tariff Barriers	High	Same	LESS	Same
Economic Policy:				
I. Fiscal/Monetary Expansion	Moderate	Same	Same	Same
II. Labor Cost Expansion	Moderate	Same	MORE	LESS
III. International Borrowing	Moderate	Same	LESS	Same

TABLE 3: WORKSHEET FOR CALCULATIONS

Nigeria	1/15/82	A.H.
Country	Date	Person

Eighteen-Month Calculation

Variable	Calculation Process		Score	Finance	Man'f./ Extract	Export
1. Political Turmoil Probability	1 + 0 (.80) + 2 (.10) + 3 (.10)	=	1.5		1.5	1.5
2. Equity Restrictions	1 + 0 (.80) + 1 (.10) + 1 (.10)	=	1.2		1.2	
3. Personnel/Procurement	2 + 0 (.80) + 1 (.10) + 2 (.10)	=	2.3		2.3	
4. Taxation Discrimination	1 + 1 (.80) + 1 (.10) + 1 (.10)	=	2.0		2.0	
5. Repatriation Restrictions	1 + 1 (.80) + 1 (.10) + 1 (.10)	=	2.0		2.0	
6. Exchange Controls	2 + 1 (.80) + 2 (.10) + 2 (.10)	=	3.2	3.2	3.2	3.2
7. Tariffs	1 + 0 (.80) + 0 (.10) + 2 (.10)	=	1.2			1.2
8. Non-Tariff Barriers	2 + 0 (.80) + -1 (.10) + 0 (.10)	=	1.9			1.9
9. Fiscal/Monetary Expansion	1 + 0 (.80) + 0 (.10) + 0 (.10)	=	1.0	1.0		
10. Labor Cost Expansion	1 + 0 (.80) + 1 (.10) + -1 (.10)	=	1.0		1.0	
11. International Borrowing	1 + 0 (.80) + -1 (.10) + 0 (.10)	=	.9	.9		.9
	TOTAL			5.1	13.2	8.7
	MEAN			1.7	1.89	1.74

Notes

1. Place current level in first blank and scale: Low=0; Moderate=1; High=2; Very High=3.

2. Scale forecast change in next three blanks so that Less=-1; Same=0; Slightly More=.5; More=1; Much More=2.

3. Parentheses contain probability of each of the three regimes.

4. Letter rank scaled as follows from numerical score:

0.00-25=A+	.76-1.00=B+	1.51-1.75=C+	2.26-2.50=D+
.26-.50=A	1.01-1.25=B	1.76-2.00=C	2.51-2.75=D
.51-.75=A-	1.26-1.50=B-	2.01-2.25=C-	2.76-3.00=D-

(Using the key above, the letter grades on Nigeria for this worksheet would be: Finance, C+; Manufacturing/Extractive, C; Export, C+.)

EXERCISE 4: Based on your work in Chapters II and III, complete the blank summary forecast and calculate the risk scores using the blank worksheet, both of which appear below

SUMMARY OF EIGHTEEN-MONTH FORECAST

Risk Ratings by Sector: Finance, Manufacturing/Extractive, Export,

Risk Factors under Three Most Likely Regimes (with Each Regime's Likelihood)

Current Level

Political Turmoil

Restrictions on International Business:

I. Equity
II. Personnel/Procurement
III. Taxation Discrimination
IV. Repatriation
V. Exchange Controls

Trade Policy:

I. Tariffs
II. Non-Tariff Barriers

Economic Policy:

I. Fiscal/Monetary Expansion
II. Labor Cost Expansion
III. International Borrowing

WORKSHEET FOR CALCULATIONS

Country ____________ Date ______ Person ______

Eighteen-Month Calculation

Variable	Calculation Process	Score	Finance	Man'f./ Extract	Export
1. Political Turmoil Probability	___+___( )+___( )+___( ) =	☐		☐	☐
2. Equity Restrictions	___+___( )+___( )+___( ) =	☐		☐	
3. Personnel/Procurement	___+___( )+___( )+___( ) =	☐		☐	
4. Taxation Discrimination	___+___( )+___( )+___( ) =	☐		☐	
5. Repatriation Restrictions	___+___( )+___( )+___( ) =	☐		☐	
6. Exchange Controls	___+___( )+___( )+___( ) =	☐	☐	☐	☐
7. Tariffs	___+___( )+___( )+___( ) =	☐			☐
8. Non-Tariff Barriers	___+___( )+___( )+___( ) =	☐			☐
9. Fiscal/Monetary Expansion	___+___( )+___( )+___( ) =	☐	☐		
10. Labor Cost Expansion	___+___( )+___( )+___( ) =	☐		☐	
11. International Borrowing	___+___( )+___( )+___( ) =	☐	☐		☐
	TOTAL		☐	☐	☐
	MEAN		☐	☐	☐

Notes

1. Place current level in first blank and scale: Low=0; Moderate=1; High=2; Very High=3.
2. Scale forecast change in next three blanks so that Less=-1; Same=0; Slightly More=.5; More=1; Much More=2.
3. Parentheses contain probability of each of the three regimes.
4. Letter rank scaled as follows from numerical score:

0.00-.25=A+
.26-.50=A
.51-.75=A-
.76-1.00=B+
1.01-1.25=B
1.26-1.50=B-
1.51-1.75=C+
1.76-2.00=C
2.01-2.25=C-
2.26-2.50=D+
2.51-2.75=D
2.76-3.00=D-

APPENDIX I: ANNOTATED BIBLIOGRAPHY ON POLITICAL RISK ANALYSIS

ANNOTATED BIBLIOGRAPHY ON POLITICAL RISK ANALYSIS

Agodo, Oriye. "The Determinants of U.S. Private Manufacturing Investments in Africa." *Journal of International Business Studies* (Winter 1978):95-107.
Examines the factors determining U.S. private investment in Africa by looking at a sample of 33 U.S. firms having 46 manufacturing investments in 20 African countries. Mail and direct interviews were used to acquire the data. A strong relationship was found between perception of political stability and amount of investment.

Ball, George W., ed. *Global Companies: The Political Economy of World Business*. Englewood Cliffs, N.J.: Prentice-Hall, 1975.
Series of general essays by business and government leaders on the role of multinational corporations in the world economy. One chapter focuses on what companies can do to reduce political risks.

Bennett, Peter D., and Robert T. Green. "Political Instability as a Determinant of Direct Foreign Investing in Marketing." *Journal of Marketing Research* (May 1972):182-187.
Empirical study of the relationship between national and political stability and the direct investment by U.S. firms in marketing activities. Questions the results of much of the previous literature. Political instability was not found to discourage such investment.

Bergsten, C. Fred. "Coming Investment Wars?" *Foreign Affairs* (October 1974):35-152.
Details types of constraints host countries place on multinationals and discusses reasons for the consequences of their constraints.

Blank, Stephen, with John Basek, Stephen J. Kobrin, and Joseph La Palombara. *Assessing the Political Environment: An Emerging Function in International Companies*. (Report No. 794.) New York: The Conference Board, 1980.
Discussion of political risk evaluation as it is used by several large multinationals. Formal procedures for assessment and forewarning of political risk are also considered. Several case studies are presented; management's attitudes toward risk assessment in its present state are discussed.

Boarman, Patrick M., and Hans Schollhammer, eds. *Multinational Corporations and Governments*. New York: Praeger, 1975.
Sixteen brief chapters on a variety of topics relevant to international business. Except for a brief statement by the then president of OPIC, the book does not deal directly with political risk. However, it does present a useful overview of the underlying conditions affecting relations between governments and MNCs.

Bradley, David G. "Managing Against Expropriation." *Harvard Business Review* (July-August 1977):75-83.
Surveys types of expropriation that have occurred between 1960 and 1976. Discusses geographical patterns, other causes of expropriatory actions, types of industrial sectors expropriated, and the composition of the ownership of expropriated companies.

Bunn, D.W., and M.M. Mustafaoglu. "Forecasting Political Risk." *Management Science* (November 1978):1557-1567.
An applied procedure is presented in this paper which has been used to forecast some of the political risks an oil company faces from investment in an overseas developing country, e.g., expropriation, taxation, price, and production controls. The procedure makes use of a panel of experts, and requires their estimates to be formulated in a way that takes explicit account of the conditions for each of the adverse actions that the host country could take. A Bayesian method is used to derive the composite probabilities for the political risk events under consideration and a cross-impact analysis then provides a means of overall scenario generation.

Cateora, Philip R. "The Multinational Enterprise and Nationalism." *MSU Business Topics* (Spring 1971):49-56.
Discusses why countries pursue policies of creeping expropriation or domestication. Argues that "predetermined or company initiated domestication of foreign firms may prove equitable to the host and foreign investor alike."

Channon, Derek F., and Michael Jalland. *Multinational Strategic Planning*. New York: AMACOM, 1978.
A 24-page chapter in this book, entitled "The Management of Political Risk," provides a series of charts and brief statements on the risks faced by MNCs, how to rate those risks for a particular project, and methods of reducing risk. One useful section is a series of questions to be asked about risks for a particular project, called the "political acceptability profile."

De la Torre, Jose. "Foreign Investment and Economic Development: Conflict and Negotiation." *Journal of International Business Studies* (Fall 1981):9-33.

Discussion of the general relationship between foreign investment negotiations and economic development considerations of the host country. Written from the point of view of how the host country can benefit. Provides a discussion of the issues arising from foreign direct investment activities in developing countries.

Einhorn, Jessica P. *Expropriation Politics*. Lexington, N.C.: Heath, 1974.

Discussion of the U.S. response to the Peruvian expropriation of the International Petroleum Company.

_____. "International Bank Lending: Expanding the Dialogue." *Columbia Journal of World Business* (Fall 1978):123-124.

Discusses the need for banks to watch their exposure to country risks. Also covers the type of supervision provided by the Federal Reserve and the Comptroller of the Currency in monitoring the exposure of U.S. banks to country risk. Discusses the need for international supervision.

Fayerweather, John, and Ashok Kapoor. *Strategy and Negotiation for the International Corporation*. Cambridge, Mass.: Ballinger, 1976.

Overview and a series of cases on how to negotiate with individuals in host countries when making public or private foreign investments. It shows how political conditions and governmental policies interact with commercial factors in shaping the negotiation process.

Gebelein, C.A., C.E. Pearson, and M. Silbergh. "Assessing Political Risk of Oil Investment Measures." *Journal of Petroleum Technology* (May 1978):725-729.

Examination of a system developed by Shell Oil to forecast best and worst scenarios in a given political climate. Extensive discussion of the precautions taken to overcome the problems of the Delphi method of forecasting. Focuses on the extractive industry.

Green, Robert T., and Christopher M. Korth. "Political Instability and the Foreign Investor," *California Management Review* (Fall 1974):23-30.

Discusses traditional political science methods for measuring instability and comments on relevance to international business. Shows measures to be quite weak.

Haendel, Dan. Foreign Investments and the Management of Political Risk. Boulder, Colo.: Westview Press, 1979.

Survey of research and methods of political risk analysis, at least from an American point of view. Begins with a general discussion of the factors that contribute to political risk and the role played by the U.S. government. Examines definitions of political risks and examines as well as criticizes existing approaches, including the BERI index, the Shell system, and the Political System Stability Index. Concludes with a discussion of incorporating political risk analysis into business decision making.

Heuer, Richards J., Jr., ed. Quantitative Approaches to Political Intelligence: The CIA Experience. Boulder, Colo.: Westview Press, 1978.

A series of essays discussing the application of quantitative techniques to political intelligence activities. Relevant essays include a discussion of cross-impact analysis to forecasting conditions in Rhodesia; the use of expert-generated data to forecast political violence in Ethiopia, Argentina, and Thailand; and a data base for the analysis of transnational terrorism.

Kahley, William J. "Assessing Economic Country Risk." Economic Review (June 1981):32-39.

Brief summary and explanation of economic factors contributing to political risk. Includes a partial list of government and private publications that provide data for the evaluation of economic factors affecting risk. From the Federal Reserve Bank of Atlanta.

Kapoor, Ashok, and J.J. Boddewyn. International Business-Government Relations: US Corporate Experience in Asia and Western Europe. New York: AMACOM, 1973.

A survey of the kinds of interactions between host governments and MNCs. Discusses mistakes corporations make in dealing with host governments and how interactions can be maintained that benefit the corporation. Looks at relationships between business and governments as both opportunities and risks.

_____, ed. The Multinational Enterprise in Transition: Selected Readings and Essays. Princeton: Darwin Press, 1972.

Series of essays that cover most aspects of international business from a general perspective. Includes chapters relevant to political risk by Harry G. Johnson, John Fayerweather, Franklin R. Root, and Raymond Vernon.

Kobrin, Stephen J. "The Environmental Determinants of Foreign Direct Manufacturing Investment: An Ex-Post-Empirical Analysis." Journal of International Business Studies (Fall-Winter 1976):29-43.

Explores the relationship between foreign direct investment (FDI) and the economic, social, and political aspects of the environment. Although a strong relationship is found between flows of FDI and market-related variables, no relationship can be established between FDI and variables based upon political events data. The findings are consistent with a view of political discontinuities as necessary, but not sufficient, conditions for business risk.

_____. "The Forced Divestment of Foreign Enterprise in the LDCs." International Organization (Winter 1980):65-88.

Statistically examines over 500 cases of forced divestment in several LDCs between the years 1960 and 1976. Discusses and presents evidence to support the assertion that most forced divestment is planned by LDCs, not executed on a spur-of-the-moment basis. Also subdivides forced divestments by industry and country.

_____. "Political Risk: A Review and Reconsideration." Journal of International Business Studies (Spring/Summer 1979):67-80.

Review of the literature dealing with the assessment and evaluation of political risk by managers in international firms. Builds upon this literature by extending and more precisely defining the concept in a manner that facilitates integration into the planning or decision-making process. Suggests directions for future research.

_____. "When Does Political Instability Result in Increased Investment Risk?" Columbia Journal of World Business (Fall 1978):113-122.

Surveys the lack of understanding and systematic analysis of political risk for most businesses. The study shows statistically that there is no simple and direct relationship between political instability and political risk.

_____, with John Basek, Stephen Blank, and Joseph La Palombara. "The Assessment and Evaluation of Non-Economic Environments by American Firms." Journal of International Business Studies (Spring/Summer 1980):32-47.

Study using statistical techniques to analyze the different methods used by American multinationals to estimate political risk. Frequency of estimation by the firms is also studied, as is the department of the firm which is responsible for the analysis.

Kraar, Louis. "The Multinationals Get Smarter About Political Risks." Fortune (March 24, 1980):86-100.
Survey of what major companies are doing about political risk analysis.

La Palombara, Joseph, and Stephen Blank. Multinational Corporations and Developing Countries. (Report No. 767.) New York: The Conference Board, 1979.
General background on several factors inherent in host countries' views on MNC operations, host countries' and MNCs' attitudes toward each other, and the relationship between the needs of both. Based on interviews with MNC managerial personnel, host country government officials, and U.S. government officials in three countries -- Malaysia, Nigeria, and Brazil. Costs and benefits of various forms of investments to both the MNC and the host country are discussed.

Lloyd, Bruce. "The Identification and Assessment of Political Risk in the International Environment." Long Range Planning (December 1974):24-32.
"Investment decisions are based on a risk/return analysis. The author of this paper asks the basic question, 'Where do politics come into this analysis?' In the first part of the article he considers why companies expose themselves to political risk. The next section is concerned with identifying those factors of special importance internationally. The final part of the paper focuses on what alternative policies can be pursued in order to minimize exposure to risks."

Mason, R. Hal. "Conflicts Between Host Countries and the Multinational Enterprise." California Management Review (Fall 1974):5-14.
General overview of reasons for the actions taken by developing countries toward international business.

Moran, Theodore H. "Transnational Strategies of Protection and Defense by Multinational Corporations: Spreading the Risk and Raising the Cost for Nationalization of Natural Resources." International Organization (December 1974): 273-287.
Discusses what companies can do to protect themselves from nationalization:
"1. Raise capital for a venture from the host government (often through shared equity), from customers, and from international financial institutions with repayments to be made from output, rather than simply supplying capital that has been raised in the parent's own name.

2. Obtain unconditional host-government guarantees for the amount of the investment to enable creditors to threaten legal action against any commercial transactions involving the host countries and third parties if the obligations for the project are not assumed by subsequent governments." Kennecott's experiences in Chile are used to illustrate points.

_____, and Debbie Havens Maddox. "Transnational Strategies of Protection and Defense by Multinational Corporations." International Organization (Spring 1973):273-287.
Presents a study of the Chilean nationalization of the copper industry in 1971. Shows how Kennecott Copper was able to lower the costs of nationalization while Anaconda Copper was forced to take huge losses. Also discusses applications of Kennecott's strategies to other extractive industries, especially petroleum.

_____, ed. "International Political Risk Assessment: The State of the Art." Landegger Papers. Washington, D.C.: School of Foreign Service, Georgetown University, 1981.
Collection of short, general essays covering several aspects of political risk and its management. Authors include senior corporate management, experienced risk analysts, and academics. Practical applications of political risk analyses methods are discussed and debated.

Nagy, P.J. Country Risk: How to Assess, Quantify and Monitor It. London: Euromoney Publications, 1979.
Introduction to basic concepts of country risk analysis. Beginning with a clarification of the meaning of the terms associated with country risk, including "sovereign risk" and "political risk," the book discusses approaches to assessing country risk. Presents a series of checklists and questionnaires which can be used in assessing the risks facing international investors. Primarily written from the perspective of bankers, the book can be adapted to risks facing manufacturing and marketing efforts.

_____. "Quantifying Country Risk: A System Developed by Economists at the Bank of Montreal." Columbia Journal of World Business (Fall 1978):135-147.
"Rational assessments of overseas investment opportunities require a comparison of the risks of investing in nations among which size, levels of economic development, and political and institutional structures differ. This paper describes a technique developed by economists at the Bank of Montreal that enables an analyst to quantify country risk. The subject is treated from a banker's point of view in that the risk of lending abroad is examined; nevertheless, the technique offered here, with minor modifications, can easily serve to quantify the risk of direct investment."

Nehrt, Lee Charles. *The Political Climate for Private Foreign Investment*. New York: Praeger, 1970.
Discusses some general principles affecting the political setting for private investment and then applies those principles to a case study of three countries -- Tunisia, Algeria, and Morocco. Analysis of the interrelationship between historical political factors and factors influencing the success of private foreign investment.

_____. "The Political Climate for Private Investment." *Business Horizons* (June 1972):51-58.
An introductory survey of why companies need to examine political factors systematically.

"A New Supervisory Approach to Foreign Lending." *Federal Reserve Bank of New York Quarterly Review* (Spring 1978): 1-6.
Examines guidelines that the Federal Reserve Board considers useful in the monitoring and regulation of private international lending. Discusses the application of such guidelines and their effect on both the bank's abilities to monitor their portfolios and the FRB's ability to examine them.

O'Leary, Michael K., and William D. Coplin. *Political Risk in 30 Countries*. London: Euromoney Publications, 1981.
Survey of the level of political risk in 30 countries taken from the May 1981 issue of World Political Risk Forecasts. Individual country studies present a brief analysis to the background factors of political risk. Ranking the 30 countries in relation to one another provides potential investors with an estimate of the various levels of risk. Includes an explanation of the methods used in the Prince political accounting system.

Peterson, Richard E. "Political Kidnapping: A New Risk in International Business." *Interfaces* (February 197[illegible] 46-53.
Empirical analysis of the outcomes of 54 kidnappings involving international business.

Piper, James R., Jr. "How US Firms Evaluate Foreign Investment Opportunities." *MSU Business Topics* (Summer 1971): 11-20.
"In general, many US firms' overall approach to foreign investment decision making is much less sophisticated than their comparable domestic approach. The former is often characterized by a lack of breadth in consideration of important variables, a biased perspective, and by a lack of adequate preparation."

Robinson, Richard D. *Foreign Investment in the Third World: A Comparative Study of Selected Developing Country Investment Programs*. Washington, D.C.: International Division, Chamber of Commerce, 1980.
Analysis of the objectives and types of national investment promotion policies. Includes studies of the policies of 20 selected developing countries.

Robock, Stefen H. "Political Risk: Identification and Assessment." *Columbia Journal of World Business* (July-August 1971):6-20.
Brief overview of definitions of political risks, underlying factors contributing to political risks, and what companies should do about it.

_____, Kenneth Simmonds, and Jack Zwick. *International Business and the Multinational Enterprise*. Homewood, Ill.: Richard D. Irwin, 1977.
Survey of all aspects of international business. Six chapters thoroughly discuss why national governments seek to control multinational businesses and foreign investment, how they exercise their control, what companies can do about it, and how to estimate political risk. It provides an excellent introduction to basic information and concepts in understanding the political risks posed by governmental actions. It is less thorough on the political risks posed by regime change and turmoil.

Root, Franklin R. "U.S. Business Abroad and the Political Risks." *MSU Business Topics* (Winter 1968):73-80.
Brief introduction to the kinds of risk faced and what companies do about it. Calls for better political analysis.

Stobaugh, Robert B. "How to Analyze Foreign Investment Climates." *Harvard Business Review* (September-October 1969): 100-108.
Provides some ideas for scales to be used in assessing risks.

_____. "Where in the World Should We Put That Plant?" *Harvard Business Review* (January-February 1969):129-136.
Describes simple weighting procedure for assessing repatriation restrictions. Most of the article focuses on general business conditions rather than on political risk.

Thunell, Lars H. *Political Risks in International Business*. New York: Praeger, 1977.
A statistical study of the degree to which political events -- particularly instability -- affect the investment behavior of multinational corporations. The findings show that the relationships depend upon the type of instability involved.

Truitt, J. Frederick. "Expropriation of Foreign Investment: Summary of the Post World War II Experience of American and British Investors in the Less Developed Countries." *Journal of International Business Studies* (Fall 1970):21-34.
Discusses patterns of expropriation and nationalization in less developed countries, including both the causes and consequences of these acts.

Van Agtmael, Antoine W. "Evaluating the Risks of Lending to Developing Countries." *Euromoney* (April 1976):16-30.
Provides a system of analysis of country risk for banks based on a checklist which focuses on two questions: the priority of the country to the bank and the creditworthiness of the country. List contains both quantitative and qualitative data. Creditworthiness depends on political stability and ability to generate foreign exchange.

_____. "How Business Has Dealt with Political Risk." *Financial Executive* (January 1976):26-30.
Brief overview of factors to consider in assessing political risk and how to handle those risks.

Zenoff, David B. *Management Principles for Finance in the Multinational*. London: Euromoney Publications, 1980.
Chapters six and eight relate to risks facing multinational corporations. Chapter six concentrates on the public image of the multinational in the host country, and how management should balance a company's worldwide financial policies against the particular host country's needs. Chapter eight focuses on currency risk and its management. Guidelines for the most profitable approaches to handling foreign exchange movements in uncertain environments are outlined, but not from the point of view of political risk.

Zink, Dolph Warren. *The Political Risks for Multinational Enterprise in Developing Countries*. New York: Praeger, 1973.
Briefly describes factors leading to political risk and the difficulties companies have in assessing political risk. Discusses the results of a questionnaire on political risk analysis in Peru. Sent to large MNCs, it shows why companies in Peru failed to anticipate the actions taken by the Peruvian junta in the late 1960s.

APPENDIX II: SAMPLE COUNTRY REPORT -- EGYPT

Egypt

EXECUTIVE SUMMARY

A CONTINUING STRUGGLE TO CONSOLIDATE AND TO IMPROVE THE CLIMATE FOR INTERNATIONAL BUSINESS

Over the next eighteen months, President Hosni Mubarak will be faced with the difficult task of satisfying fundamentalist and nationalist pressure for more independence in foreign and economic policy while accepting from the United States the economic assistance upon which his regime depends. In addition, without restricting his efforts to allow more open political discourse, he will also need to control the fundamentalist organizations and forestall conspiracies that might develop in the armed forces.

These tasks will be made even harder by the intractable economic problems, which have been aggravated by the slump in the world economy oil prices. The major threat to Mubarak, or a government led by one of his close senior advisers, would be from a junior officer coup growing out of Islamic fundamentalism or, less likely, a resurgence of Nasserite leftist nationalism. Another possibility worth considering would be a radical Islamic fundamentalist takeover preceding or following a nationalist coup.

Under Mubarak, restrictions on international investment are likely to be slightly higher than they were under Sadat, as the government tries to regulate foreign investment while increasing incentives. Restrictions on imports will increase in order to stem the deterioration in the currency position. Under the likely alternative regimes, restrictions would be much greater, and political turmoil would increase.

Over the next five years, Mubarak has a slightly better than 50-50 chance of surviving. If he were to be replaced, it would be through a coup, either from a coalition of nationalists or Islamic fundamentalists within the armed forces. The key factors will be whether economic conditions can be improved, the fundamentalists controlled, and military discipline maintained. Much will depend upon external events, particularly the course of the world economy and the flare-up of violence in the Middle East.

SUMMARY OF 18-MONTH FORECAST

RISK RATINGS BY SECTOR:

Financial: C-
Manufacturing/Extractive: C+
Exporting: C-

Risk Factors	Current Level	THREE MOST LIKELY REGIMES (AND THEIR PROBABILITIES)		
		Mubarak or Senior Military Officer (65%)	Nationalist Military Coup (25%)	Fundamentalist Military Coup (10%)
Political Turmoil	Moderate	SLIGHTLY MORE	MORE	MUCH MORE
International Business Restrictions				
Equity	Moderate	Same	MORE	MORE
Local Operations	Moderate	SLIGHTLY MORE	MORE	MUCH MORE
Taxation Discrimination	Low	SLIGHTLY MORE	MORE	MUCH MORE
Repatriation	Moderate	Same	MORE	MORE
Exchange Controls	High	SLIGHTLY MORE	MORE	MORE
Trade Policies				
Tariffs	Moderate	SLIGHTLY MORE	MORE	MUCH MORE
Non-Tariff Barriers	Moderate	MORE	MORE	MUCH MORE
Payment Difficulties	Moderate	SLIGHTLY MORE	MORE	MUCH MORE
Economic Policies				
Fiscal/Monetary Expansion	Moderate	SLIGHTLY LESS	MORE	Same
Labor Cost Expansion	Moderate	SLIGHTLY LESS	SLIGHTLY MORE	MORE
International Borrowing	High	SLIGHTLY MORE	MORE	LESS

SUMMARY OF 5-YEAR FORECAST

RISK RATING: D+

Risk Factors	THREE MOST LIKELY REGIME SCENARIOS (AND THEIR PROBABILITIES)		
	Mubarak or Senior Military Officer (55%)	Nationalist Military Coup (25%)	Fundamentalist Military Coup (20%)
Political Turmoil	SLIGHTLY MORE	MORE	MORE
Restrictions on International Business	MORE	MUCH MORE	MUCH MORE
Restrictions on Trade	SLIGHTLY MORE	MUCH MORE	MUCH MORE
Economic Policies	Continued modest austerity and heavy borrowing	Initial expansionist policies that might be adjusted to gain foreign acceptance	More spending, but some accommodation to requirements of international financial institutions

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INDEPENDENT ESTIMATES OF COUNTRY TEAM MEMBERS

Country Team

Member A. Specialist on agricultural and energy policy conducting field research in Egypt

Member B. Ph.D. in political science teaching at a major university; consultant to the United States State Department and international business on the politics of Egypt and Israel

Member C. Ph.D. in political science who has written several books and articles on the politics of Middle Eastern countries

Member D. Government specialist on international business conditions in Eygpt

Member E. Ph.D. in Middle Eastern history, specializing in the military and political affairs of Middle Eastern countries

Member F. Teacher and writer who is familiar with both Cairo and the more inaccessible Upper Egypt

Responses of team members

Most Likely 18-Month Regime: Mubarak or Senior Military Officer

					C		F	A,B,D,E		
0	1	2	3	4	5	6	7	8	9	10
Very Unlikely		Unlikely		Uncertain			Likely		Very Likely	

Likelihood That Political Turmoil Will Affect International Business Within The Next 18 Months

			A,B,D,F	E		C				
0	1	2	3	4	5	6	7	8	9	10
Very Unlikely		Unlikely		Uncertain			Likely		Very Likely	

Likelihood Of New Restrictions On International Business Within The Next 18 Months

		B	A	D		C	E,F			
0	1	2	3	4	5	6	7	8	9	10
Very Unlikely		Unlikely		Uncertain			Likely		Very Likely	

Likelihood Of New Trade Restrictions Within The Next 18 Months

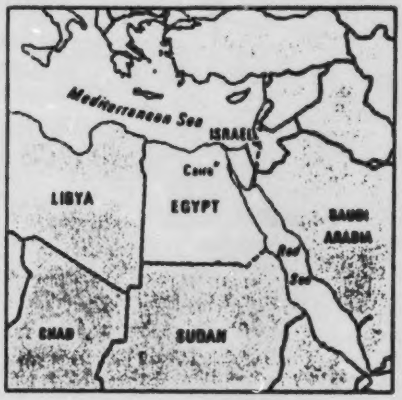
						B	A,D,F	C	E	
0	1	2	3	4	5	6	7	8	9	10
Very Unlikely		Unlikely		Uncertain			Likely		Very Likely	

Most Likely 5-Year Regime Scenario: Mubarak or Senior Military Officer

				C		F	A,E	B,D		
0	1	2	3	4	5	6	7	8	9	10
Very Unlikely		Unlikely		Uncertain			Likely		Very Likely	

Except for Member C, the panelists agree on the chance of Mubarak surviving in both the short and long term; Member C feels that the Islamic fundamentalist movement and the hostility generated by Egypt's relations with the United States and Israel will cause his downfall. The disagreement over restrictions on international business reflects concern that the government's attempt to direct foreign investment might overshadow its effort to improve conditions by reducing red tape and increasing incentives.

FACT SHEET



ARAB REPUBLIC OF EGYPT

Capital	Cairo
Population	1982, 45 million (est.)
Area	1,001,993 sq. km.
Official Language	Arabic
Independence	February 28, 1922
Constitution	September 11, 1971
Political System	Constitutional democracy
Economy	Middle income, oil exporting

POLITICAL SCENE

Head of State President Hosni Mubarak (1981)

Head of Government Prime Minister Ahmed Fuad Mohieddin (1982)

Cabinet

Mohammed Abdel Halim Abu Ghazala	Defense
Hassan Abu Basha	Interior
Ahmed Izz al-Din Hilal	Petroleum
Mustafa Kamal al-Said	Economy and Foreign Trade
Mahmud Salah al-Din al-Hamid	Finance
Kamal Hassan Ali	Foreign Affairs
Hassaballah Mohammed al-Kafrawi	Reconstruction
Yusuf Amin Wali	Agriculture
Wazih Muhammad Shindi	International Investment and Cooperation
Soliman Metwalli Soliman	Transport and Communication
Muhammad al-Sayyid al-Ghururi	Industry and Mineral Resources

Administrative Subdivisions 26 governorates

Legislature Unicameral. 392-member Majlis (Peoples' Assembly); 372 are directly elected, 10 are indirectly elected, and 10 are appointed by the president. Distribution of seats (elected members only); National Democratic Party, 330; Socialist Labor Party, 29; Liberal Socialist Party, 3; independents, 10.

Elections Majlis nominates president for 6-year term; his nomination is confirmed by plebescite. Last election, October 13, 1981; next, October 13, 1987. Members of the Majlis are elected to serve terms lasting no longer than 5 years. Last election, June 7, 1979; next must be held no later than June 7, 1984.

Status of the Press Restraints on editorial freedom are generally self-imposed, rather than because of outright censorship.

Economic Sectors of Major Government Participation

Agriculture, housing, utilities, transportation, communications, energy, banking

Currency Exchange System The pound is pegged to the dollar. On February 1, 1983, one pound equalled $1.43.

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DOMESTIC ECONOMIC INDICATORS

Gross Domestic Product:
1982, $29.6 billion (est.)
Per Capita 1982, $660 (est.)
Average real growth rate
1982, 8.1% (est.)

Inflation 1982, 25% (est.)

Labor
Average change in real wages
1981, -2.6% (est.)
Unemployment 1981, 13.6%

Work force

Agriculture	1980, 50%
Industry-Commerce	1980, 30%
Services	1980, 20%
Unions	1980, 25%

Energy

Energy Consumption per capita.
1979, 539 kg. coal
Percent of imports
1981, 2%

INTERNATIONAL ECONOMIC INDICATORS

Current Account Balance
1982, -$1.5 billion (est.)
Debt Service Ratio to Exports
1982, 18.5% (est.)

Exports 1982, $4.5 billion (est.), principally cotton, rice, petroleum, manufactured goods

Imports 1982, $10.2 billion (est.), principally foodstuffs, machinery, manufactured goods

Major Trade Partners
United States, Italy, USSR

SOCIAL INDICATORS

Population

Growth rate	1970-80, 2.1%
Infant deaths per 1000	1980, 103
Persons under 15	1981, 40%
Urban population	1981, 45%
Urban growth rate	1970-80, 2.8%
Literacy	1981, 45%

Ethnic and Nationality Groups
Egyptians, Nubians

Languages
Arabic

Religions
Sunni Moslem (92%),
Christian (Coptic) (7%)

BACKGROUND

Egyptian politics and economics have been historically linked by the need for centralized control of the Nile Valley for agricultural irrigation. About 96% of the Egyptian people have long been crowded into 4% of its land masses--the Nile Valley and Delta, and the Suez Canal Zone. Because the Nile River is surrounded in Egypt by deserts, the country's central population and agricultural zone has been well insulated from ground attack by neighboring states. This natural separation also provided the historical basis for national unity.

The Nile remains the focal point of Egyptian life today, but the extremely high population density compounds the problems of adequate food and housing, especially in the cities of Cairo and Alexandria. Despite ambitious land reclamation projects, the prospects for increasing the area under cultivation are limited.

Other basic Egyptian facilities are also inadequate. The road system is in need of substantial repair and enlargement. The communications system is inefficient with telephones functioning sporadically. Although educational facilities are overcrowded as well, Egypt does have the largest body of educated personnel in the Arab world, many of whom must leave the country to find work.

A key to Egypt's international significance is its population--the largest in the Arab world--and its possession of the Suez Canal, the vital waterway connecting the Mediterranean Sea to the Indian Ocean. The Sudan, Egypt's southern neighbor on the Nile, is a close friend despite past differences. To the west is Libya, ruled by Muammar Qaddafi, who was a bitter enemy of the late President Sadat. Although union with Libya had been proposed at one time, confrontation dominated the relationship during Sadat's later years. Egypt's relations with Libya have improved somewhat under President Hosni Mubarak, but hostility is still high.

Relations with Egypt's eastern neighbors are more complex. No longer in a state of war with Israel, Egypt has regained the Sinai Peninsula, but not the Gaza Strip, formerly part of its territory. Diplomatic relations presently exist between Egypt and Israel, and they are likely to continue, but the normalization process will probably move very slowly. On the other hand, relations with the Arab states will undoubtedly improve even further under Mubarak.

The ethnic, regional, and tribal conflicts that play important roles in other Arab states are absent from Egypt. Nevertheless, animosity, sometimes violent, divides the Christian Copts and the Arab Moslems. The Copts, officially less than 10% of the population, often complain of discrimination and second-class status. Periodic clashes between the Copts and the government marked the last few years of President Anwar Sadat's reign. The members of the Coptic minority continue to have some economic power as the owners of shops and small factories, but they have no substantial power. The highest ranking government official of Coptic background is Boutros Boutros-Ghali, the minister of state for foreign affairs.

By far the most serious social problem is the underlying conflict between the relatively small, educated, and Westernized middle class and the larger numbers of lower-class people who are poor, uneducated, and increasingly more attracted by appeals from the Islamic fundamentalists. The lack of jobs for the

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educated middle class is a source of discontent that further complicates an already tense social situation. The military, while providing a path of social mobility for some, also provides the seeds of dissent from the poor and less educated members of society which it absorbs. Serving as a safety valve for these social problems, however, is the fact that substantial numbers of Egyptians are employed in other nations of the region.

Egypt's massive economic problems are compounded by its high birth rate, low per capita income, unequal income distribution, disease, short life expectancy, illiteracy, emigration of the educated, and rising expectations of social and economic improvement, heightened by the Egypt-Israel Peace Treaty. Some progress has been made in dealing with each of these problems, but they remain far from resolution. The increasing need for food is Egypt's central economic and social problem. The desire for further industrialization and investment is frustrated by the huge Egyptian bureaucracy. Massive economic assistance, formerly from Gulf Arabs and presently from the United States and the West, has made some needed improvements in the infrastructure possible while at the same time fueling inflation.

Informal Sources of Power

Egypt has experimented with several political styles since the 1952 revolution. It is likely that President Mubarak has maintained much of the existing structure, both formal and informal, although he has opened up the system somewhat. Ultimately, his power depends on the support of the military.

Egypt has a strong presidential system of government. The president appoints all leading officials, including the vice-president, the prime minister, and Cabibet. He is also supreme commander of the armed forces, an extremely important role since the military is the most likely source of change in the government. The National Assembly's formal legislative power is circumscribed by the power and authority of the president, who dominates all aspects of life in the country and who has the right to rule by decree. All crucial political and economic decisions are made by the president with the aid of his closest advisers. Policy is carried out by Egypt's senior officials, who also serve with the confidence of the president, and by the vast bureaucracy which supports them.

Mubarak is likely to continue in the tradition of his predecessors, tightly controlling the highly centralized political system. Senior office holders are personally selected and retain their positions as long as he has confidence in their loyalty and usefulness. Despite public statements to the contrary, Mubarak is also likely to engage in periodic reshuffling of his government to help retain loyal subordinates as well as to prevent the accumulation of too much power or prestige by any potential aspirant for leadership.

The system of centralized control has also tended to reduce the ability of political figures to establish power bases for potential leadership roles in the government. Popular and well-known public figures often seem to fade into oblivion once removed from positions of power. In addition, Egypt has not established any effective institutions for political participation by the masses.

Attempts by Egypt's leadership to create enduring political institutions have resulted in a series of legislatures and political parties that have been little more than facades for authoritarian rule. None of the various party systems created in Egypt since the 1952 revolution have allowed genuine and widespread mass political participation, despite the routinely large voter turnouts when both Gamal Abdel Nasser and Anwar Sadat were reelected president and despite substantial support given to government policies in various referenda. Mubarak has shown some interest in opening the system. He has freed many opposition figures whom Sadat had jailed and has permitted some expression of different views. Over the past six months, however, he has moved against the opposition, jailing those associated with the violent extremist viewpoints of Islamic fundamentalists.

The government sees the need for foreign investment in the economy, but remains ambivalent about its effects. Efforts to facilitate foreign investment have taken the form of both legislation and less formal incentives, always guided by the government's efforts to maximize the Egyptian benefits from investment. Private enterprise continues to be a small part of the economy, while numerous public sector companies remain as part of Nasser's and Sadat's legacy. The government encourages foreign, private sector involvement, but Sadat had little to equalize the ratio between the public sector and Egyptian private companies. Both the left and right opposition have criticized the government for its heavy involvement with Western enterprise, the left because it is capitalistic, and the right because it is not sufficiently Islamic. Mubarak has reaffirmed his support of an open-door policy, but this will not be achieved at the expense of the public sector.

Egypt's large number of public workers receive low wages, and their productivity is low. Many of the better educated and trained workers are employed in the private sector, in other Arab countries, or in the West. Middle-level managers and others with related skills are in especially short supply, primarily because the education system does not prepare students for these jobs.

A central feature of the Egyptian business environment is the large role played by government-owned industries. These include such heavy industries as steel and automobile production. Considerable pressure exists to reduce the number and scope of these industries, and also to reduce corruption. Various ministers have taken strong public stands on streamlining investment procedures, and some new procedures have been announced. So far, however, these efforts have not had much effect.

Major Political Issues

The four major issues that dominate Egyptian politics are economic policies to alleviate Egypt's fundamental economic problems; relations with Israel, the Arab world, and the West; the creation of a more open and institutionalized political system; and the effort to streamline and reduce corruption in the bureaucracy.

The Egyptian economy suffers from the spending necessary to support subsidies for consumer essentials, as well as a significant current-account deficit, unemployment, lack of skilled labor, and inefficiency in the public economic sector. The beneficial results from attacking these problems would not show for some time. The political opposition will most certainly be too impatient to wait for any efforts to bear fruit. This could produce major threats to the regime. Sadat tried to remove subsidies for bread, but the resulting riots in January 1977 caused an abrupt about-face. Despite the IMF's recommendations for reducing or terminating the urban food subsidies, President Mubarak has pledged,

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at least for the time being, to leave them untouched. Moves to reduce imports and to provide better management of business under government control will antagonize the middle class. Steadily growing inequalities and high population growth make failure to deal with these problems a constant source of political dissent. Strong economic action by Mubarak is sure to provoke political controversy.

Related to the other decisions is the question of relations with the West and the Soviet bloc. Sadat's close ties with the United States, partly an outgrowth of the Camp David accords and the Egypt-Israel Peace Treaty, have had economic and military benefits. But many Egyptians think the benefits should have been greater. People from both the right and the left oppose all close ties with the capitalist and non-Islamic West. Mubarak is likely to begin loosening some ties with the United States, although his dependence on American economic aid will limit his movement.

Relations with Israel and the Arab states remain the key international issue. The return of the easternmost and final portion of the Sinai would seem likely to pave the way for further normalization. Israel's June 1982 invasion of Lebanon put Egypt, the only Arab country to have diplomatic relations with Israel, in a difficult position, Egypt vigorously protested the invasion, but chose not to recall its ambassador from Tel Aviv until after the massacre of Palestinians by Lebanese Phalangists in the refugee camps of Sabra and Chatila.

Egypt's relationship with the Arab world was on its way to improvement under Mubarak, at least until the Israeli invasion of Lebanon. Individual Arabs are beginning to spend more in Egypt. But official Arab aid, cut off with the signing of the 1979 peace treaty, has yet to be resumed. Nevertheless, Egypt's main source of hard currency continues to be the remittances of Egyptians working in the Peninsula and the Gulf (estimated at $2.5 billion in 1982). Despite the rejection of Egypt at the Fez Summit in September 1982, Mubarak will seek, probably with some success, to move closer to the moderate Arab states.

The United States will continue to reward Egypt's moderate stance with generous aid. Egypt's unique ability to be in communication simultaneously with the Arab states, Israel, and the PLO, as well as Egypt's critical strategic location, makes it a valuable ally to the United States.

President Mubarak also faces a dilemma with respect to political institutions. As long as the army is the dominant source of political power, authoritarian rule will continue, and political pressures that develop within the society will lead to violence and turmoil. Mubarak recognizes the need to open the political system, not only to maintain his own rule, but eventually to lead to a more stable and responsive government. Shortly after Mubarak came to power he surprised many observers by raising issues related to political freedom. Less than two months after Sadat's assassination, Mubarak released many of the moderate leaders imprisoned by Sadat in September 1981. Since then he has jailed other leaders, but the arrests have been confined to members of major extremist groups, including pseudo-Messianic groups and openly revolutionary armed bodies. These are not the moderates that Sadat arrested in 1981. In fact, two fundamentalist figures jailed by Sadat, Ikhwan Chief Umar al-Tilmisani and popular fundamentalist preacher Sheik Kishk were not only released, but have written articles for the government party's religious paper, Al-Liwa' al-Isalami. The NPUP and the SLP, two political parties, have been allowed to publish their views again. The press has shown a vigor which has been unknown since the spring of 1978 when real freedom of the press flourished for a few weeks before being suppressed.

Other issues which Mubarak has faced are the rampant corruption in Egypt and the administrative inefficiency of the bureaucracy. Recognizing the need to eliminate corruption in order to gain support from the fundamentalist right and the general public, and to reduce administrative inefficiency in order to attract foreign investment, Mubarak has made strong statements and taken some specific actions to deal with the problem. These actions included the sentencing of several relatives of the late President Sadat--his half brother along with three of the brother's sons. In addition, Mubarak has simplified exporting procedures. While support for such action is widespread, the difficulty in making meaningful changes and the costs to be incurred by those who now benefit from such conditions may weaken Mubarak's support in the long run.

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POLITICAL ACTORS

The numbers below summarize the data used to produce the risk forecasts and the decision structure charts in this report. A +100 indicates maximum support and a −100 indicates maximum opposition. Numbers in parentheses indicate the relative importance of neutral actors. Page numbers indicate which actors are described in this section. The probability of each action, calculated according to the method described in User's Note 6, is reported as a range.

ACTOR	MOST LIKELY REGIME Mubarak or Senior Military Officer	POLITICAL TURMOIL	INTERNATIONAL BUSINESS RESTRICTIONS	RESTRICTIONS ON TRADE
Mohammed Abdel Halim Abu Ghazala (Deputy Prime Minister and Defense Minister), p. B-3	+32	-40	-5	-
Kamal Hassan Ali (Deputy Prime Minister for Foreign Affairs), p. B-3	+12	-7	-	-
Armed Forces, p. B-3	+24	-48	-	-
Boutros Boutros-Ghali (Minister of State for Foreign Affairs), p.B-4	-	-12	-	-
Communist Party, p.B-5	-40	+20	-	-
Economics Ministries, p.B-5	-	-	-8	-8
Egyptian National Front (ENF), p.B-6	-40	+20	+5	+5
Abd Rabb al-Nabi Hafiz (Chief of General Staff), p. B-7	+16	-16	-	-
Intelligence and Security Forces, p. B-7	+38	-60	-	-
Islamic Fundamentalists, p. B-9	-12	+38	+19	+13
Israel, p. B-11	+10	-	-	-
Mustafa Khalil, p.B-12	-	-	-	+12
Ahmed Fuad Mohieddin (Prime Minister), p.B-12	+20	-20	+2	+2
Hosni Mubarak (President), p. B-12	+60	-80	-14	-7
National Progressive Unionist Party (NPUP), p.B-13	-19	+10	+12	+12

POLITICAL ACTORS

ACTOR	MOST LIKELY REGIME Mubarak or Senior Military Officer	POLITICAL TURMOIL	INTERNATIONAL BUSINESS RESTRICTIONS	RESTRICTIONS ON TRADE
Osama el-Baz , p. B-14	-	-	-14	-14
Radical Arab States, p. B-14	-3	+7	-	-
Saudi Arabia, p. B-15	+26	-	-7	-
Ibrahim Shukry, p. B-16	+8	-8	+2	+2
Soviet Union, p. B-16	-10	-	-	-
United States, p. B-17	+19	-12	-14	-5
PROBABILITY RANGE	60%-70%	19%-29%	34%-44%	52%-62%

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MOHAMMED ABDEL HALIM ABU GHAZALA (DEPUTY PRIME MINISTER AND DEFENSE MINISTER)

Defense minister of Egypt and former military attache in Washington, Abu Ghazala was a strong supporter of Sadat and of his Western-oriented foreign policy. He attained his post after the helicopter crash that killed his predecessor, Ahmed Badawi. Ghazala has no strong power base in or outside the military and appears to support Mubarak and his policies. He is said to take a hard-line view toward dissidents. He was promoted to the rank of field marshal in April 1982 and deputy prime minister in August 1982 over the heads of several more senior officers.

Abu Ghazala is increasingly mentioned as a possible prime minister or, even more likely, vice-president. The vice-presidency has been vacant since Mubarak's accession. Considerable pressure is being raised to name someone to become the successor to the president. The candidates appear to be Abu Ghazala, whose associations with the United States may hurt his chances, and Foreign Minister Ali, who is acceptable to other Arabs, but is in ill health. Abu Ghazala, in early 1983, seemed to be favored by Mubarak. If Abu Ghazala becomes vice-president, Chief of General Staff Lt. Gen. Abd Rabb al-Nabi Hafiz would succeed him in defense. His influence in the army may actually be greater than Abu Ghazala's.

In 1982 Abu Ghazala began giving extensive interviews on foreign policy and even economic issues. As a candidate for the vice-presidency or the prime ministership, or both, he not only has a liability in his close American ties, but also in the allegations, repeated by the opposition in the People's Assembly, that he was involved in dubious transactions with the Egyptian-American Transportation Corporation (EATSCO). These allegations also involve Kamal Hasan Ali. But since Mubarak's brother-in-law, Gen. Munir Sabet is also involved as a former procurement officer in the United States, little further exposure of the alleged misdeeds is likely.

KAMAL HASSAN ALI (DEPUTY PRIME MINISTER FOR FOREIGN AFFAIRS)

Appointed foreign minister in May 1980 and put in charge of the negotiations for peace with Israel, Lieutenant General Kamal Hassan Ali retained post in the Cabinet changes of August 1982. General Ali has a well-deserved reputation for effective management and assertive decision-making. He was a loyal subordinate who pursued Sadat's policies and appears to hold the confidence of Mubarak as well. His overall objective appears to be to improve Egypt's relations with both the Arab states and the Western powers. Ali rose through the ranks of the Egyptian army to become head of military intelligence and subsequently minister of defense and war production and commander in chief of the armed forces. He is frequently mentioned as a possible vice president, although his age and uncertain health may prevent this.

ARMED FORCES

With a standing force of 460,000 regulars and an additional 335,000 reservists, the armed forces are a major source of power in Egypt. They have been the foundation of the government's power. The last three Egyptian leaders have attained power through the army or, in the case of Mubarak, as a result of an assassination in which members of the armed forces were implicated. Mubarak has a very close relationship with Field Marshal Abdel Halim Abu Ghazala, who is his deputy prime minister and defense minister and places a high priority on maintaining military discipline.

However, several factors raise questions about the long-term support of the armed forces. First, Mubarak's air force background reduces his support from the army. Second, Ghazala was promoted very quickly ahead of several senior officers, and he is a political figure whose strong stand on foreign policy issues sometimes costs him support. Third, the armed forces have been politicized by their participation in the talks with Israel over the return of the Sinai and in the efforts to neutralize Islamic fundamentalism in its ranks. At the rank of captain and below great inroads have been made by Islamic fundamentalism. Fourth, members of the armed services are not well paid and, the caliber of recruits is not high. Finally, as a result of peace with Israel and the reduction in tension with Libya, the armed services have no major outside threat and, except for the Sudan, are not likely to be called upon as an ally.

Over the next few years, any change in government is likely to occur as a result of a military coup. While the armed services continue to be the main source of current support for Mubarak, they also are the main threat to his political survival.

Mubarak has made several minor changes in the military leadership. More extensive changes have been made in the ranks of company officers and below, where members of fundamentalist movements have been closely watched; those with ties to the extremist Jihad and similar groups have been mustered out (usually with full pension rights). Officially, the involvement of military personnel in the Sadat assassination has been played down, and another military plot in Mansura a few weeks earlier has been kept out of the press.

BOUTROS BOUTROS-GHALI (MINISTER OF STATE FOR FOREIGN AFFAIRS)

A Coptic Christian, from a distinguished Egyptian family, Boutros Boutros-Ghali was educated in Europe and speaks French and English fluently. A former professor of political science at Cairo University, he served as minister of state for foreign affairs under Sadat and retained his position in the January 1982 Cabinet changes following Mubarak's succession to the presidency.

Although Boutros-Ghali is a significant figure in foreign policy and a mainstay of the peace negotiations process, he is somewhat suspect in the eyes of some Egyptians for his role in the peace process and Egyptian foreign policy more generally. This has not been helped by the fact that Ghali's wife is an Egyptian Jew, many of whose relatives now live in Israel. Ghali also suffers from the fact that his namesake ancestor, Prime Minister Boutros-Ghali, was disgraced and assassinated for his involvement in the 1906 Dinshwai incident, in which British troops killed Egyptian peasants. The Boutros-Ghalis remain, however, probably the most prominent non-clerical Coptic family.

Boutros-Ghali is an intellectual and career diplomat. As a Copt with a Jewish wife and a former close associate of Sadat's, he is effectively excluded from ever becoming foreign minister. But he should retain the minister of state position, barring a politically motivated shift. Should Foreign Minister Kamal Hasan Ali be promoted to a higher post, Boutros-Ghali might retain his present

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post without a Cabinet minister above his minister of state post, or he might even be made foreign minister. On the other hand, Osama el-Baz, director of the President's Office for Foreign Affairs, may stop him from rising any higher in the Cabinet.

Boutros-Ghali has numerous foreign contacts and appears to support the continuation of Sadat's policies, particularly with regard to its economic opening and closer links with the West.

COMMUNIST PARTY

The small Egyptian Communist Party was founded in 1921 and has been illegal for most of the time since then. Suspected members and sympathizers are regularly detained, but reports of the party's activities are almost impossible to verify. Its membership is probably only a few hundred. The party appears to have held its first congress in Egypt in the late 1970s, and it participated in the 26th Soviet Communist Party congress in Moscow in 1981.

The Egyptian Communist Party's positions have been broadcast and published on a regular basis. Its opposition to Sadat and Mubarak has emphasized the Arab-Israeli conflict, attacking Israel's aggressive policy, and advocating the maximum territorial rights of the Palestinians. The party sees the Palestinian issue as part of the international struggle against imperialism, of which Israel is a bridgehead. Israel is considered a racist colonialist entity, and Sadat's peace process, continued by Mubarak, is attacked as a capitulation to the Zionists. The Communist Party is searching for a revolutionary doctrine that would unite all the Arabs.

The party opposed Sadat's links with the United States and the involvement of capitalists in the Egyptian economy. In present Egyptian politics, the Communist Party has only a minor role. Among other things, its appeal runs against the tide of resurgent Islamic fundamentalism.

ECONOMICS MINISTRIES

Since the Cabinet reshuffle in August 1982, Egypt has, for the first time in several years, been left without a deputy prime minister assigned specifically to Economic Affairs. The last person to hold that post, Mohammed Abdel Fattah Ibrahim, lasted for only eight months. Instead, individual ministers report directly to Prime Minister Ahmed Fuad Mohieddin. Previously, the deputy prime minister for economic affairs had coordinated the separate ministries.

The ministers in charge of coordinating economic policy include Economy and Foreign Trade Minister Mustafa Kamal al-Said, Finance Minister Mahmud Salah al-Din al-Hamid, Petroleum Minister Ahmad 'Izz al-Din Hilal, Irrigation Minister Muhammad Abd al-Hadi Samaha, International Investment and Cooperation Minister Wagih Muhammad Shindi, Reconstruction Minister Hasaballah al-Kafrawi, Supply and Internal Trade Minister Ahmed Ahmed Nouh, Industry and Mineral Resources Minister Muhammad al-Sayyid al-Ghururi, Agriculture and Food Security Minister of State Yusuf Amin Wali, and a variety of other ministers of state. The list alone shows why an overall economic affairs minister is needed.

Some ministers surviving from the Sadat era have also been implicated in charges of influence-peddling and corruption, and will almost certainly be removed by late 1983. This will allow Mubarak an opportunity to install his own men to head the key ministries, and perhaps to name a new economic affairs minister. Until the expected changes take place, some doubt will remain about the future direction of Mubarak's economic ministries.

EGYPTIAN NATIONAL FRONT (ENF)

Established in 1980 under the leadership of former Chief of General Staff Lt. General Saad el-Din Shazli, the Egyptian National Front (ENF) is the best-known opposition exile group. Members of the organization include a Nasserite group, an Islamic fundamentalist faction, the Egyptian Communist Party, and a coalition of leftist expatriates in Beirut. It has been recognized by Syria, Libya, Algeria, Southern Yemen, and the PLO.

After Sadat's assassination, the front shifted its headquarters from Damascus to Libya, vowing to continue its work. Shazli contends that the ENF is supported by several Arab states. In fact, however, Libya's Qaddafi provides most of the financial assistance. The ENF sought to depose Sadat, and after his assassination, Shazli promised violence against Mubarak, saying that the group would persist until it had established democracy.

General Shazli was the popular and respected chief of staff of the Egyptian armed forces from 1971 to 1973, including the period of the October war. He and the president had basic disagreements over the conduct of the 1973 war. Subsequently, he served as Egypt's ambassador in London and Lisbon. In 1978 he spoke out against Sadat, resigned his post, and has since remained in exile.

Shazli opposed Sadat's policy on the Arab-Israeli conflict because he believes that the Camp David agreement politically separated Egypt from the other Arab countries, weakened it militarily, and forced Egypt to follow the West. Israel, he fears, will eventually come to dominate the Middle East because of Egypt's Western alliances.

Shazli called Sadat's assassination a patriotic act against a traitor and stressed the need to replace the existing regime with a democratic system. He seeks democracy, but in the economic sphere he wants controls similar to those of Nasser, to enable a fairer social distribution of wealth. The ENF seeks a significant reduction of presidential power, but has no precise program for achieving that end. The front's manifesto called for terminating Egypt's peace treaty with Israel and breaking the alliance with the United States. The ENF would seek to undo many of the economic liberalization schemes propounded by Sadat and would make the climate for foreign business activity less favorable, should it assume power.

Shazli and the Egyptian National Front have been considerably weakened as a result of their inability to capitalize on the Sadat assassination. Always subject to internal conflict, the front is faced with defections as a result of the modest political opening that Mubarak has so far engineered. General Shazli's family, which has repudiated him, continues to live in Egypt. The impact of General Shazli's group and the other exile groups is negligible.

Shazli still enjoys some support within the armed forces, but his identification with Libya is unpopular. Egypt's gradual unofficial re-acceptance by other Arab states has decreased their support of Shazli, except for Libya and Syria. He is seldom heard of; Mubarak has effectively thwarted his largely personal anti-Sadat campaign simply by not being Sadat. Contacts aimed at allowing Shazli to return to Egypt are rumored between Shazli and the government through journalist Muhammad Hassanein Heikal, but these are officially denied.

ABD RABB AL-NABI HAFIZ (CHIEF OF GENERAL STAFF)

Hafiz is second to Abu Ghazala in the military establishment of Egypt and would be the one most likely to succeed Ghazala in the defense ministry if he moves up in the government.

Hafiz was born in Cairo in 1930, educated at the War College, and served as an infantry officer. (His 16th Infantry Division was one of the first across the Suez Canal in 1973.) He became general secretary in the War (now Defense) Ministry and later was deputy director of Military Intelligence. He then returned to the field, and by 1979, became commander of the Second Field Army-- one-half of Egypt's ground forces. He was promoted to chief of operations, and when much of the high command died in a helicopter accident on March 2, 1981, he was named chief of General Staff, replacing Abu Ghazala. Unlike Abu Ghazala, he shows little interest in politics.

INTELLIGENCE AND SECURITY SERVICES

The various intelligence and security services remain major influences on the Egyptian political scene. A legacy of the Nasser era, they have been restricted in their authority since the 1971 "Corrective Revolution," when Sadat foiled a challenge to his state leadership by the party and the intelligence apparatus. Sadat purged the leadership of the security services, but was not averse to using them himself.

GENERAL INTELLIGENCE (Mukhabarat al-'Amma), now headed by Fuad Nassar, is the main civilian overseas intelligence agency; to a considerable extent, it also handles internal security functions, although it is not the only internal security force. General Intelligence is one of the few intelligence services in the world whose senior officers have, in many instances, received training both from Soviet and American intelligence agencies, as a result of Egypt's shift in alignment.

MILITARY INTELLIGENCE (Mukhabarat al-Harbiyya). Military Intelligence comes under the Ministry of Defense, and includes officers of all the military services. Like most military intelligence operations, its duties include collecting data on the military forces and political stability of potential enemies. Many Egyptian military attaches abroad are Military Intelligence officers. The present chief is Labib Sharab.

STATE SECURITY (Amn al-Dawla). Egypt has several state security services all controlled by the Ministry of the Interior. The regular police forces are concerned with traffic and other everyday matters. There are special security police as well as state security forces who possess paramilitary equipment for special use. The only time since 1952 that the Egyptian Army has been used for domestic security was during the January 1977 food riots. To prevent their being used in this way again, state security forces were upgraded with military equipment. (Much of the reported incidence of troops in the streets after the Sadat assassination were, in fact, state security troops in their green uniforms. Because they wore combat helmets, carried automatic weapons, and traveled in armored personnel carriers, Western reporters unfamiliar with Egypt described them as soldiers.) The present interior minister, Hasan Abu Basha, was in charge of State Security Investigations and was thus chief of the security forces and police prior to his promotion. Assistant Interior Minister Abd al-Karim Darwaysh apparently carries out those functions today.

President Mubarak, as vice-president and immediately after he became president, was engaged in quelling rivalries within the various security services. The head of General Intelligence until 1981, Muhammad Said al-Mahi, was a leading anti-Mubarak figure in the clique around Sadat. He, along with Jihan Sadat, Marwan Hasan, Sayyid Marei, Osman Ahmed Osman, and a few others, saw Mubarak as an upstart without family, business, or other loyalities to Sadat, and thus not a real party of the inner circle.

The General Intelligence hostility to Mubarak led to what many insiders interpreted as a clear favoritism toward Military Intelligence after the Sadat assassination. This does not appear to have lasted, if only because Military Intelligence was somewhat sullied by the alleged involvement of a Military intelligence officer, Lt. Col. Abbud al-Zumur, in both the Sadat assassination and the Asyut uprising. His position was never officially acknowledged, and the approximately simultaneous military mutiny in Mansura was also de-emphasized, barely appearing in the press.

Military Intelligence and the armed forces were entrusted with the investigation of the Sadat assassination. Since a Military Intelligence officer was involved, and since the assassins fired from an artillery column (artillery being Defense Minister Abu Ghazala's own branch), accusations were inevitable. State Security, in particular, felt it had had its prerogatives seized by a service whose objectivity was compromised. Tension continued until early 1982, when Maj. Gen. Darwaysh of State Security met with Deputy Defense Minister Ahmad Shawqi at the Command and Staff College and made peace.

Because the interior minister controls the State Security and Police apparatus, he is directly responsible for controlling internal dissidence and violence. General Intelligence and Military Intelligence also play roles here, but the primary police functions fall under the Interior Ministry.

Sadat's last interior minister, Muhammad Nabawi Ismail, had enormous power, but quickly lost it after Mubarak's accession. He was replaced by Hasan Abu Basha.

At the time of his appointment, Abu Basha had more than thirty years of police work behind him, and had been a State Security policeman since that service was formed after the 1952 revolution. He graduated from the Police College in 1945, but then took his degree in law at the University of Cairo before entering the police. After joining the Security Police at its formation, he quickly rose through the ranks. By 1968 he held the rank of colonel in the investigations branch, Egypt's criminal investigation division.

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With Anwar Sadat's "Corrective Revolution" of 1971, when the various security and intelligence services were purged of their anti-Sadat Nasserite elements, Abu Basha was made deputy director of investigations. He soon was made director--equivalent to head of the State Security service itself--and held this post at the time of the food riots and subsequent arrests in 1977. In 1978, after yet another move by Sadat against his opponents, Abu Basha was made deputy minister of the Interior for security. In that capacity, he supervised the widespread arrests of September 1981.

When Nabawi Isma'il, the interior minister, was removed in January 1982 Abu Basha became interior minister. His career experience as a Security Police officer has made him assume a harsh attitude toward potentially troublesome groups, but also appears to have made him a typically loyal officer, obedient to directions from the top. Abu Basha has worked well under Nasser, Sadat, and Mubarak; if he has higher ambitions, they have not become evident.

ISLAMIC FUNDAMENTALISTS

The Islamic fundamentalists believe that the Shari'a (Moslem Laws) should be the sole basis for the government and that the only elements of Western society and modernization that can be injected into the government and society are those consistent with the teachings of the Prophet.

They view the modern world from an Islamic perspective and call for a radical restructuring of society. Mostly younger individuals than those in the Moslem Brotherhood, they preach a return to fundamentals and tradition and a rejection of the secularism, the materialism, and what they see as the corruption that has characterized Egypt, especially its urban centers, for several decades. Politically, the Islamic fundamentalists are opposed to the West, Communism, Israel, the Camp David process, and the Egypt-Israel peace treaty. They are militant and completely dedicated to their cause. Ironically, their strength at present is partly the result of the official encouragement they received in the mid-1970s, when Sadat saw them as a counterweight to the neo-Nasserite left.

The fundamentalists' strength is uncertain, but a concrete manifestation of their influence may be the increased attendance at mosques. Though the number of hard-core activists is generally estimated at 10,000, their audience is certainly in the millions. An indication of their strength and relative independence from government control is the existence of an estimated 40,000 private mosques that have sprung up in Egypt over the past several years. The principal group is the Moslem Brotherhood, *Al-Ikhwan*, formed in 1928. Long influential, it provided men and ideas for the Free Officers Coup in 1952, but its power declined under Nasser. Although not allowed to organize as a political party, the brotherhood spreads its beliefs through a network of associations and several publications. One of them, *Al-Da'wah* (The Call) was widely read until Sadat closed it in late 1981. In early 1983, its premises were returned to its editors, but no license has been issued to resume publication. While ostensibly against violent action, the brotherhood has a history of political assassinations and secret networks. In late 1982, the Mubarak regime arrested large numbers of the Jihad organization, a fundamentalist Moslem group that is one of the many that threatens the government. It was accused of involvement in both the Sadat assassination and the uprising in Asyut in Upper Egypt.

Many of the Islamic fundamentalist groups are of lower middle-class origins and appear to have increasing strength on the university campuses. Furthermore, sympathy for Islamic causes is substantial and is increasing among members of the middle and upper-middle classes. The fundamentalist groups provide a safe avenue for protest against a variety of government policies, ranging far beyond just religious issues.

The fundamentalists evidently receive foreign financial support. The government of Libya and private individuals and groups in Saudi Arabia and the Persian Gulf are the most likely sources of outside funds. In addition, supporters working abroad, often in Saudi Arabia and the Gulf, sometimes remit funds to the fundamentalist cause as well as to their families. It is likely that the Egyptian government, through its intelligence and security services, has penetrated the larger and more powerful of the fundamentalist groups and is fully aware of their activities and plans.

While the Islamic fundamentalists can make trouble by demonstrations and riots and thus pave the way for others, they themselves are not yet sufficiently organized to seize the government. Their chance of takeover rests, therefore, in working with or subverting the military officer corps in order to use the army in their quest for power.

Islamic fundamentalism is the most serious force now confronting the government. Its strength and appeal are growing, as larger and larger numbers of Egyptians, faced with overwhelming social and economic problems, take refuge in this kind of Islamic faith. Mubarak's strategy of trying to separate the moderates from the extremists has worked so far, and could work over the long run, if economic conditions improve and Mubarak continues to maintain a religious image.

Mubarak's approach to the fundamentalists has been somewhat more careful than was that of Sadat. Sadat at first encouraged the Ikhwan and other groups, citing his own ties with the organization before the revolution, and then, in 1981, turned against all the fundamentalist groups with a fury. By that time, with his encouragement, the Islamic Associations controlled the universities, and could close down the Upper Egyptian universities at any time.

Mubarak's approach has been to conciliate the moderate fundamentalists, those who do not preach political violence against the state. This includes the mainstream Ikhwan; Al-Da'wah is expected to resume publication in 1983. Meanwhile, Mubarak's ruling National Democratic Party has started its own religious weekly, Al-Liwa' al-Islami (the Islamic Banner), which has published articles by such opposition figures as Ikhwan leader (and Al-Da'wah publisher) Umar al-Tilmisani, and the popular anti-Sadat preacher, Sheikh Kishk. Even at Sadat's most open encouragement of the fundamentalists, such exposure in official publications was not permitted.

But Mubarak has been especially harsh with the radical revolutionary groups such as Jihad; a number of small movements, usually following a religious leader and probably consisting of no more than a handful of fanatics, have also been extensively publicized, presumably in an attempt to create a popular image of radical fundamentalists as zealots believing in impossible messiahs.

The Islamic Associations controlling the universities under Sadat have not formally been reconstituted, but the strength of the associations is still

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considerable. They provided essential services, such as photocopies of textbooks without paying copyright fees, in place of officially supplied, expensive foreign texts. But their involvement in the Asyut uprising in 1981 has discredited their loyalty.

In February 1983 the Egyptian press began reporting the story of the 1981 Asyut uprising, but the full story of that incident has not been told. Most police and security forces in Asyut were defeated and the rail connection with Upper Egypt was cut for several days. The government officially denies what eyewitnesses confirm, namely that the fundamentalists essentially ruled Asyut until army paratroops retook the city.

The fundamentalist strength is still greatest in Upper Egypt, in such universities as Minya and Asyut, which draw their students from that region.

ISRAEL

Israel has a strong influence on Egypt's positions and policies. The two countries are linked by the Camp David accords and by the Egypt-Israel Treaty of Peace of March 1979. Under the terms of those documents Israel and Egypt have been engaged in talks designed to achieve some form of autonomy for the Palestinians and have been working toward normalization of relations. The normalization process was interrupted by Israel's Lebanon invasion. Sharp disagreements about what constitutes meaningful Palestinian autonomy and on the future of the West Bank are formidable barriers to improved relations.

Israel did at least complete its withdrawal from the Sinai Peninsula in April 1982. The two countries have exchanged ambassadors, and the border between them has been opened. Egypt's relationship with Israel has led to an estrangement with much of the Arab world, however. President Mubarak has consistently spoken out about Palestinian rights, and during his visit to Washington in early 1983 he stressed the importance of the Israeli withdrawal from Lebanon. It is unlikely that Israel will break the current relationship with Egypt.

Relations chilled considerably after Israel's invasion of Lebanon. In September 1982 after the Beirut massacres, Egypt withdrew Ambassador Sa'd Murtada from Tel Aviv, saying he would not return until Israeli troops have left Lebanon. (When an ambassador does return, it probably will not be Murtada, who is too closely identified with Sadat.) Egypt is also taking a strong position in the dispute over the Sinai border at Taba, near Eilat, which was aggravated by the opening of an Israeli hotel in the disputed territory. The Egyptian press has become more critical of Israel than at any time since Sadat's Jerusalem visit in 1977.

Egypt's objections to Israeli actions, however, appear to be an attempt to express independence, demonstrate to other Arabs that Egypt, while at peace, is not an Israeli ally, and, most of all, to respond to Egyptian public opinion, which has been disappointed by the lack of economic improvement from peace and disturbed by the war in Lebanon.

If only for reasons of military reality and the need for continued American support, Egypt could not seriously consider an abandonment of its peace with Israel.

Nor is there any desire for war among the people. But the nature of the peace and the resumption of normal business and cultural interchange have been altered by Lebanon and Egypt's reconciliation with other Arab states.

MUSTAFA KHALIL

Mustafa Khalil served as prime minister of Egypt between 1978 and 1980, and is chairman of the Arab National Bank. Although he has no formal position in the current Cabinet, he retains senior party posts and has emerged as an influential advocate of reform in economic policy. He is among the candidates frequently mentioned to replace Mohieddin as prime minister in a possible Cabinet reshuffle.

Khalil is a leading proponent of a system of national economic planning and having a central authority to determine priorities and direct investment, and is critical of many aspects of the open economic policy implemented under President Sadat. He has stated that the free trade zones have become havens for smugglers. Khalil has also called for the elimination of state enterprises currently under the inefficient management of government ministries.

AHMED FUAD MOHIEDDIN (PRIME MINISTER)

Fuad Mohieddin was named prime minister by President Hosni Mubarak and formed a new Cabinet in January 1982. Mubarak had held the post of prime minister himself since October 1981, but the office had traditionally been separate from the presidency until assumed by President Sadat in May 1980.

Mohieddin became first deputy prime minister when Mubarak was prime minister. He has served in Parliament, was chairman of the foreign affairs committee, and has been governor of three different provinces. He was minister of health from 1974 to 1976.

Mohieddin has a reputation as a man of integrity, although not as a strong personality; he is quite acceptable to Egyptians. Some businessmen fear he is too supportive of government intervention in industry. He has, however, become a favorite target of the opposition press, especially Ibrahim Shukry's Al-Sha'ab, largely because it is less dangerous to attack the prime minister than the president. Persistent rumors suggest that he may be replaced or may be shifted to the chairmanship of the National Democratic Party and replaced as prime minister. Mubarak publicly scoffs at such rumors.

HOSNI MUBARAK (PRESIDENT)

Hosni Mubarak, who succeeded Anwar Sadat as president of Egypt following his assassination in October 1981, was chosen and groomed by Sadat for his position. Mubarak was a taciturn air force general when he became vice-president in 1975. He was selected because he presented no political threat, was politically inexperienced, and loyal. A graduate of both the Egyptian War College and the Egyptian Air Force Academy, Mubarak became chief of staff of the Egyptian air force in 1969 and later its commander in chief. He is highly respected in Egypt for his able and effective management of the Egyptian air force during the years of training and preparation for the 1973 war.

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Despite some training in the Soviet Union, Mubarak is known to be staunchly anti-USSR. Over the years he served Sadat well and was included in most of the negotiations Sadat undertook with various world figures. Mubarak learned a good deal about Egypt's economic, political, and military problems during his service as vice-president.

The transition to the presidency was smooth. Mubarak was immediately elected to a full six-year term of office by the People's Assembly. He is committed to maintaining unchanged such fundamental tenets of Sadat's program as the Open Door policy, close ties with the United States, and honoring the peace treaty with Israel. He has been able to win a considerable measure of public support. Except for the extreme Islamic right, support has been forthcoming from all major elements of the political spectrum. Modifications of the Sadat policies are, nevertheless, taking place. Normalization of relations with Israel has been slowed, but they are fully consistent with the letter of the peace agreement. Conciliatory steps are being taken to mend relations with the Arab states and with the PLO.

While relations with the United States will remain firm, the ties are not quite as close. Scheduled joint military maneuvers with the United States' Rapid Deployment Force have been postponed until summer 1983. A tentative relationship with the USSR was reestablished by admitting some 60 Soviet technicians--a largely pragmatic gesture. Political controls over the domestic opposition have been somewhat relaxed, at least temporarily, the press has been granted more freedom, and some measures to curb corruption have been instituted. Most important of all, Mubarak has conveyed his serious desire to deal with the perennial economic crisis. Meanwhile, he has quietly and thoroughly evaluated the military and made appropriate personnel changes, knowing that his ultimate base of support will continue to rest on the armed forces.

Mubarak surprised many people with his political skill. During the last year of Sadat's life, rivals attempted to undermine or replace Mubarak. Several of those rivals had already lost power before Sadat's death, as a result of well calculated defensive maneuvers by Mubarak. In power, his caution has led to some criticism, but beginning October 1982, after the first anniversary of his accession, he began to show new signs of forming a government more to his own tastes.

NATIONAL PROGRESSIVE UNIONIST PARTY (NPUP)

Leftist opposition to the regime in Egypt has centered around the National Progressive Unionist Party (NPUP), also known as the Al-Tagamm party. The party claims to unite all the left-wing forces in Egyptian society that emerged after the 1952 revolution. Under Sadat's policy of political liberalization, the Egyptian leftists formed a faction within the Arab Socialist Union in 1976 that later became a full-scale party, the NPUP. It is led by Khalid Mohieddin, one of the officers who overthrew King Farouk in 1952 and was closely linked with Nasser and Sadat.

The party has links with the various communist groups in Egypt and continues to be the focal point of the legal left opposition to the regime's policies. Mohieddin attended the Moscow Communist Party congress in 1981 at the invitation of the Central Committee. The party has argued for the need to change the government of Egypt and to adopt a new economic program.

In foreign policy the focus of the left opposition has been the Camp David process and Egypt's cooperation with the United States. The NPUP supports the Soviet Union's proposal for peace and security in the Persian Gulf area. Although it has not expressed a detailed policy on international business, the NPUP clearly believes that the economic and social policies have not helped the masses, but have benefited mainly those closely associated with the regime.

The NPUP failed to win a seat in the general elections of June 1979, but not without government interference in the balloting. It claims a membership of about 25,000. Its power is slight and the party appears to have little ability to change the policies and programs of the government on economic or political matters.

Following Sadat's assassination the NPUP stressed the need to replace the current regime with a democratic system rather than allowing Mubarak to take on all of Sadat's perogatives.

Nevertheless, under Mubarak Khalid Mohieddin has been permitted to be interviewed in the official press; and the Nasserite moderates within the NPUP, at least, are less harassed than they were under Sadat. Despite widespread arrests of NPUP officials in his September 1981 purge, Sadat never arrested Khalid Mohieddin, apparently because the latter was one of the original Free Officers.

The party's lively weekly newspaper Al-Ahali was suppressed in 1978 after only a few months, but has resumed publication under Mubarak. While the NPUP itself appeals to a small elite of Nasserite intellectuals and some professional people, Al-Ahali enjoys a somewhat wider leadership.

OSAMA EL-BAZ

A staff aide to Mubarak when he assumed the presidency and director general in the Foreign Ministry, Osama el-Baz is a Western-educated expert on foreign affairs. He became a speechwriter for Mubarak, offers general advice and, in effect, is head of the president's office. He is officially director of the President's Office for Foreign Affairs, with a ministerial portfolio. He is gaining influence over Egyptian foreign policy and is likely to be a major figure in the government. He is supportive of international business and relations with the United States, although he is likely to pursue a hard line on the Middle East peace process.

Although he is the main architect of Egypt's foreign policy at the moment, observers doubt that he will formally be made foreign minister because of a reputation for abrasiveness in negotiations and a disdain for protocol. Israeli negotiators at Camp David found him the most unyielding negotiator present and believe his ascendancy will stiffen Egypt's stance on dealing with Israel.

RADICAL ARAB STATES

The Camp David agreements led to tension and conflict between President Anwar Sadat and the more radical states of Syria, Iraq, Libya, and South Yemen,as well as the PLO. Relations with Libya were particularly strained because Sadat suspected Muammar Qaddafi of meddling in the politics of Sudan as part of a plan to dominate the entire area.

In the short period that President Mubarak has been in office, he has spoken of Egypt's support of the Arab nations' international political goals, and the official press has not attacked the radical Arab states. Even under Sadat, Egypt was selling arms to Iraq and supporting that country in its battle with the Ayatollah Khomeini's Iran. The Iraqis invited Egypt to the nonaligned nations conference,scheduled but not held in Baghdad in November 1982, and the PLO has expressed an interest in improving ties with Egypt. There has even been talk that Yassir Arafat will eventually make Cairo his headquarters.

Mubarak seems genuinely concerned with improving relations between Egypt and the rest of the Arab world, and he is less likely than his predecessor to take steps that will antagonize those states. He will be cautious in developing ties with Israel. In any event, the radical states have little political advantage over Egypt. Syria is torn by internal strife; Iraq is in the midst of its war with Iran; and the PLO is internally divided. Reconciliation with Egypt will come about slowly, beginning with trade and restoration of diplomatic relations. The unwillingness to seat Egypt at the Fez Summit in September 1982 was a setback to the steps for reconciliation.

Iraq, which in many respects no longer belongs to the radical Arab camp at all, seems likely to strengthen its ties with Egypt. Iraqi leaders have expressed a willingness to renew relations; Osama el-Baz visited Baghdad in February 1983; and even a possible visit to Cairo by Saddam Hussein has been discussed. Iraq may lead the way in restoring official diplomatic relations well ahead of such conservative states as Morocco and Saudi Arabia, which retain only unofficial ties.

SAUDI ARABIA

Despite a continuing lack of formal diplomatic relations, Saudi Arabia is once again becoming a key partner in Egyptian policy making and in support of the Egyptian economy. The personal feud between Sadat and the Saudi princes never involved Mubarak, who in fact regularly conducted quiet meetings with the Saudis in Muscat and Khartoum even during the Sadat era. Any remaining personal animosity was dispelled when Mubarak attended King Khalid's funeral, despite a lack of formal relations.

The number of Saudi diplomats in Egypt is now almost as large as when the two countries had formal relations. Cairo is again attracting large numbers of Saudi tourists and businessmen. Egyptian newspapers are available again in Saudi Arabia, where they are widely read.

Formal reestablishment of relations is blocked only by Saudi caution and their unwillingness to be first, since the break was called for by joint Arab League action. If no joint Arab meeting agrees to lift the ban, the Saudis will at least wait until some other states take the lead. But both Saudi investment in Egyptian projects and the movement of Saudi funds into Egypt are increasing; in everything except formal diplomatic protocol, relations are nearly the same as in 1977.

One reason is the Saudi recognition that Egypt is the keystone to its own regional defense. The Egyptian base at Ras Banas, planned as a forward base for the Rapid Deployment Force, is directly across from the Saudi port of Yanbu, now the Red Sea outlet for new oil and gas pipelines. Ras Banas is intended to provide air cover for northwestern Saudi Arabia, and rebuilding Egypt's military forces is a prime Saudi priority.

Saudi Arabia appears prepared, as it was before 1977 as well, to underwrite an Arab arms industry in Egypt. Saudi funds may already be involved in Egypt's local production of the French Alpha Jet; they certainly are a part of plans to build the Mirage 2000 and perhaps the US F-20 (formerly F-5G) in Egypt. The OPEC price fall may cause some retrenchment, especially in Saudi plans to buy new naval vessels for Egypt.

IBRAHIM SHUKRY

Shukry is the senior statesman and head of the opposition Socialist Labor Party. The party is small, with only 7 seats in Parliament, but it is well organized and, with a sophisticated ideology, it offers an alternative form of government. The Socialist Labor Party has a wide network of followers and sympathizers as indicated by the fact that its newspaper Sha'ab had a circulation of 100,000 when Sadat banned it in 1981. (It has since resumed publishing.)

Shukry's importance and potential influence is recognized; Mubarak has consulted with him frequently since taking over as president in October 1981. While opposed to normalizing relations with Israel, the SLP is generally supportive of the regime. It continues to criticize any restrictions on political freedom and to advocate the return of Egypt to the Arab fold. Under Mubarak, it has resumed publication with renewed vigor. The SLP was formed with Sadat's encouragement as a safe alternative to the leftist NPUP; it soon began taking its role as opposition party seriously.

SOVIET UNION

The principal ally of Egypt during the Nasser years, the USSR's relations with Egypt deteriorated under President Anwar Sadat, who expelled 17,000 Soviet technicians and military advisers in 1972. In the period following the October 1973 war, Sadat linked his diplomatic and economic policies to improved relations with the United States and had virtually no contacts with the Soviet Union. The final break came in September 1981 when the Soviet ambassador, six other diplomats, and the remaining 1,000 Russian technicians were sent home after the Egyptian president accused the diplomats of spying and attempting to subvert his regime.

President Mubarak has openly stated his intention to restore relations with the USSR. At Egypt's request, technicians have been sent to help run the Aswan Dam and a Soviet-built steel mill at Helwan. A trade agreement, is expected to be completed soon; diplomatic relations will likewise resume, probably before summer 1983. Ties with other East-bloc countries, including trade, are also improving.

The Egyptians do not intend to break their ties with the West in favor of close and exclusive ties to the Soviet Union. Mubarak has said that the USSR has no role to play in the Camp David negotiations. Furthermore, he is unlikely to place American economic aid in jeopardy by aligning himself too closely with Moscow. Even when relations were at their best, the Soviet Union was most forthcoming with arms and technicians, not financial aid. The most important role the Soviet Union plays is as a potential supporter--a role the Egyptian government can use to convince the American government that its support should be continued.

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UNITED STATES

As Egypt's largest supplier of foreign aid--over $1 billion a year since 1975--the United States has become important to the Egyptian government. President Sadat looked to the United States exclusively as the political and economic ally of Egypt and expected American aid to improve the Egyptian economy. He also thought that American investment would lead to a revitalization of the Egyptian private sector.

However, economic ties with the United States have produced only modest gains. Most of the aid has been tied to specific projects, a practice that the Egyptians resent. United States investment, which reached $1.03 billion at the end of 1980, has been smaller than anticipated and has been confined largely to banking, petroleum, and tourism. Trade has grown, but mostly in United States exports, which totalled $2.8 billion in 1982 and were made up largely of agricultural products. American imports from Egypt were $458 million in 1982.

The Agency for International Development asked for $750 million for Egypt under its Economic Support Fund for 1983, about the same level as the previous year, out of a total of $4.7 billion requested for programs worldwide, not including the Caribbean Basin Initiative. More than half of this assistance goes to the Middle East, primarily Egypt and Israel. The Food for Peace Program has also been important. In 1982 the United States provided over $300 million for various programs. From 1952 through 1982 the United States provided about $2.5 billion. Total economic aid for 1983 is set at about $2.3 billion, almost as much as is planned for Israel.

In setting economic policy, Egyptian leaders are constrained to consider the reaction of both the United States government and the private sector. Extensive restrictions on private business would be contrary to the goals of maintaining high levels of American public assistance and expanding trade and private investment.

In late 1982, a series of articles began appearing in the usually conservative weekly Al-Ahram al-Iqtisadi, a business magazine. These articles attacked the size of the American presence in Egypt, particularly AID and various research foundations, including the Social Research Institute at the American University. The theme was picked up by other publications and, although the Egyptian government officially says the press is free to make such criticisms, the appearance in the conservative press of attacks on "Egypt's shadow government" (as the articles characterized the United States) suggest that the government is concerned about the excessive visibility of American researchers.

A certain aloofness has also become visible in the military relationship. Defense Minister Abu Ghazala publicly announced that joint American-Egyptian maneuvers had been "postponed" until the summer of 1983, even though, in fact, they had never been planned for any earlier time. Contradictory statements by the American and Egyptian governments in February 1982 about the presence of American AWACS in response to a Libyan threat to Sudan were another example of the fact that the two countries can easily find themselves at cross-purposes.

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REGIME STABILITY

Summary

President Mubarak has a good chance of remaining in power despite major sources of discontent. The most likely threat to his continued rule, or to the rule of one of the top military leaders who is now part of his regime, is a nationalist military coup supported by Islamic fundamentalists and possible left-wing nationalist elements who identify with Nasser's political views. A military takeover by Islamic fundamentalists is less likely but possible, particularly if a nationalist coup occurs first.

Most Likely Regime--Mubarak or Senior Military Officer (65% Likelihood)

The chances are good, but not so good as a year ago, that President Mubarak will continue in power over the next eighteen months. His cautious approach to the political opposition and to economic policy has muted opposition to his rule, and his use of harsh measures to jail extremists and change personnel in the army has served to buttress his regime. He has, however, had little success in improving economic conditions, and he is caught in a foreign policy position which forces him to antagonize PLO supporters in the country.

As a result, deep-seated and dangerous opposition to his regime continues. Outbursts of urban social unrest, fueled by poor economic conditions, will be avoided only by continued price subsidies for essentials and by curtailing some of the excesses of Sadat's open-door policies. A round-up of Islamic fundamentalists in late 1982 and an extension of the state of national emergency for another 12 months indicate how tight the situation really is.

Perhaps Mubarak's biggest problems are that he has no popular appeal, and is unwilling to take bold action. Sadat and Nasser each commanded support from both the elite and the masses by such bold actions. Mubarak has demonstrated a cautious, even hesitant, style that may lose him support.

As long as the military sticks together and provides support for the regime, Mubarak is likely to continue in power. Only a massive public upheaval that results in a breakdown in the military's discipline, or a well-planned coup, could displace Mubarak. Although there is some chance that senior officers may force him to step down, that is a case in which the change in leadership would not result in a significant change in policies.

Second Most Likely Regime--Nationalist Military Coup (25% Likelihood)

If a coup were to occur by other than the most senior military officers, junior officers who advocate more nationalistic policies than Mubarak's would be the most likely source. These officers would be drawn from moderate fundamentalists or from Nasserite elements still within the armed forces. Both viewpoints might be represented, and the new regime would try to establish initial support from both Islamic fundamentalists and left-wing politicians.

Conditions that would contribute to the possibility of such a takeover include continued inflation and unemployment, the perceived threat of Islamic extremists, the fear of a breakdown in public order, continued dependence upon the United States, the inability to improve relations with radical Arab states, a failure of the intelligence and security forces to maintain control, and the inability to reduce corruption. The chances of such a takeover are relatively small because of Mubarak's conscious efforts to work with both the fundamentalists and the left, and his continued vigilance through the intelligence and security apparatus. Ultimately, however, his pragmatic approach and low-keyed style could cost him the support he has so far received.

If a nationalist military coup were to occur, considerable change in Egypt's foreign policy could be expected. There would be a decided move away from the close relations with the United States and toward an independent foreign policy. Relations with the radical Arab states would be improved considerably, and relations with Israel would decline. Cooperation with the Soviet Union would increase, but would still be limited.

This regime would be unstable from the beginning and could be a prelude to an Islamic fundamentalist regime. Alternatively, a counter-coup engineered by senior officers could occur. A nationalist military regime would be faced with the need to attract economic support without alienating radical forces, the same dilemma that Mubarak now faces.

Third Most Likely Regime--Fundamentalist Military Coup (10% Likelihood)

An Islamic fundamentalist regime could also emerge out of a military takeover. Junior officers, emboldened by their commitment to a fundamentalist viewpoint, could overthrow the regime or could stage a coup following action by less ideologically committed military officers. All of the things that contribute to the possibility of a nationalist coup also contribute to the possibility of an Islamic fundamentalist takeover. The lack of organization for the kind of mass movement that was orchestrated in Iran makes it less likely, however, that a fundamentalist takeover would occur, unless the coup organizers themselves are able to implement fundamentalist policies once they get into power. While the hard core of the Islamic fundamentalists is not large, their sympathizers permeate the society. These sympathizers are particularly significant among the educated lower middle classes, because they are often the most intelligent and active former villagers who are new arrivals in Cairo and other urban centers.

World Political Risk Forecasts

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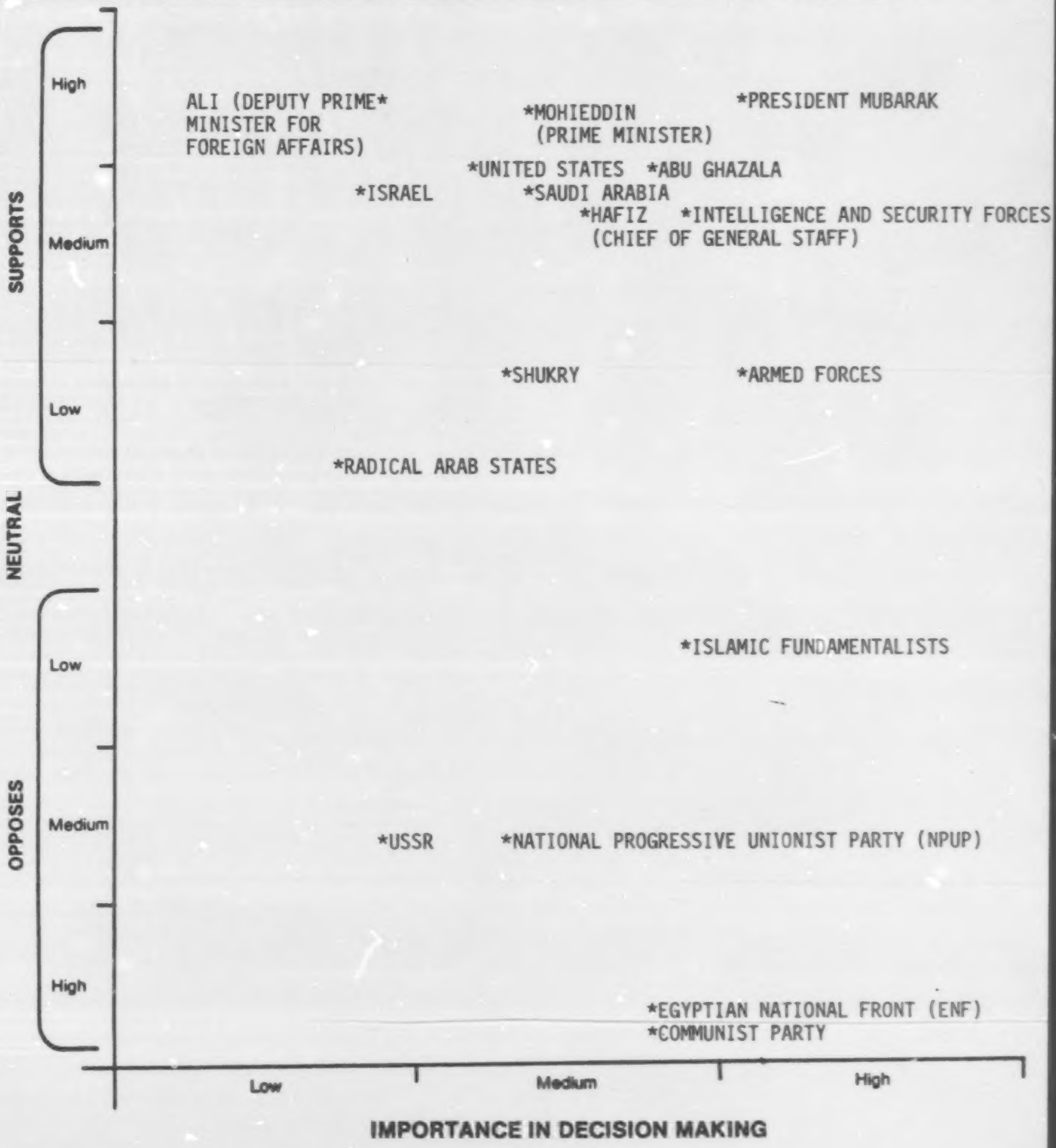
FROST & SULLIVAN

DECISION STRUCTURE

Country
EGYPT

Date
April 1, 1983

MOST LIKELY REGIME--MUBARAK OR SENIOR MILITARY OFFICER



POLITICAL TURMOIL

Summary

Economic and social conditions that have given rise to political turmoil in the past continue today. While the current regime is likely to keep turmoil to a minimum, isolated demonstrations and terrorist attacks are likely to occur. A nationalist or an Islamic fundamentalist takeover could spark massive turmoil and even civil war.

18-Month Forecast of Turmoil Under the Three Most Likely Regimes

CURRENT LEVELS: MODERATE. Political turmoil is a common part of recent Egyptian history, first against the British, then against the monarchy, and later against the regimes of Gamal Abdel Nasser and Anwar Sadat. The basic economic and social conditions that produced much of the previous turmoil have hardly changed at all.

Since the overthrow of King Farouk in 1952, Egyptians have often taken to the streets to express their feelings about political developments. In 1977 Egypt was faced with rioting in response to a government decision to reduce subsidies and increase prices on foods and staples.

Although the riots caused some loss of life and numerous injuries, the effects on business were slight and confined primarily to local shops and businesses in the area of rioting. Foreign business was not the target of the demonstrators and did not suffer losses. Indeed, the last time foreign businesses were a target for outbursts was January 1952, six months before the toppling of the monarchy.

Limited demonstrations followed the assassinations of President Sadat. Increasingly, the political turbulence is directed by Islamic fundamentalist forces. Internal reaction to the Israeli invasion of Lebanon and to the perceived Israeli and American responsibility for the September 16-18, 1982 massacre of Palestinian refugees by Lebanese Christian militia in west Beirut was contained by Egyptian security forces.

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY MORE. Mubarak will take steps to make sure that the business climate is not disrupted by political turmoil, domestic or international. The president is well aware that political unrest would be most unfavorable to the continued climate for foreign investment. The very purpose of a more open policy was to encourage investment, and while it has not always met expectations, nothing will be done to discourage the process.

Despite Mubarak's resolve and the immense military capability at his disposal, demonstrations as well as terrorist attacks continue to be a threat. Mubarak, like his predecessor, is constrained in the implementation of economic policies that would directly affect the public's standard of living. Fearing a repeat of the 1977 violence, he is not likely to reduce subsidies substantially. It is likely that Mubarak will continue to maintain control; however, throughout the next 18 months, isolated incidents will occur as the middle and lower classes become impatient with the lack of improvement in the Egyptian economy that Mubarak, and peace with Israel, were supposed to deliver.

NATIONALIST MILITARY COUP: MORE. Events surrounding a nationalist takeover, along with the possibility of attack from Mubarak supporters as well as Islamic fundamentalists, make it likely that substantial increases in turmoil would occur. Even if control were quickly established, the new government would have to placate Islamic fundamentalist forces or face violent mass opposition. By placating the fundamentalists, the regime would also have to deal with the possibility of destabilizing actions from the United States, Saudi Arabia, international financial sources, the Israelis and other Arab states. Even if no direct intervention took place, actions by external actors could stimulate mass and elite opposition throughout the country.

FUNDAMENTALIST MILITARY COUP: MUCH MORE. Much of the economic dissatisfaction is found in the ranks of the urban lower-middle class, not among the desperately poor in the urban and rural areas. After going to secondary schools and the universities, these lower-middle-class people, if they are lucky, find only poor paying government jobs, which do not enable them to acquire even the basics of modern living. Their concern is only materialistic; it is also based on a loss of traditional values. With 10 to 12 million people crowded in the Cairo area, any widespread demonstration can bring commercial activity to a halt. This was demonstrated by the January 1977 food price riots, which constituted the most serious threat to President Sadat prior to his assassination, and in fact posed a far greater challenge to the system itself.

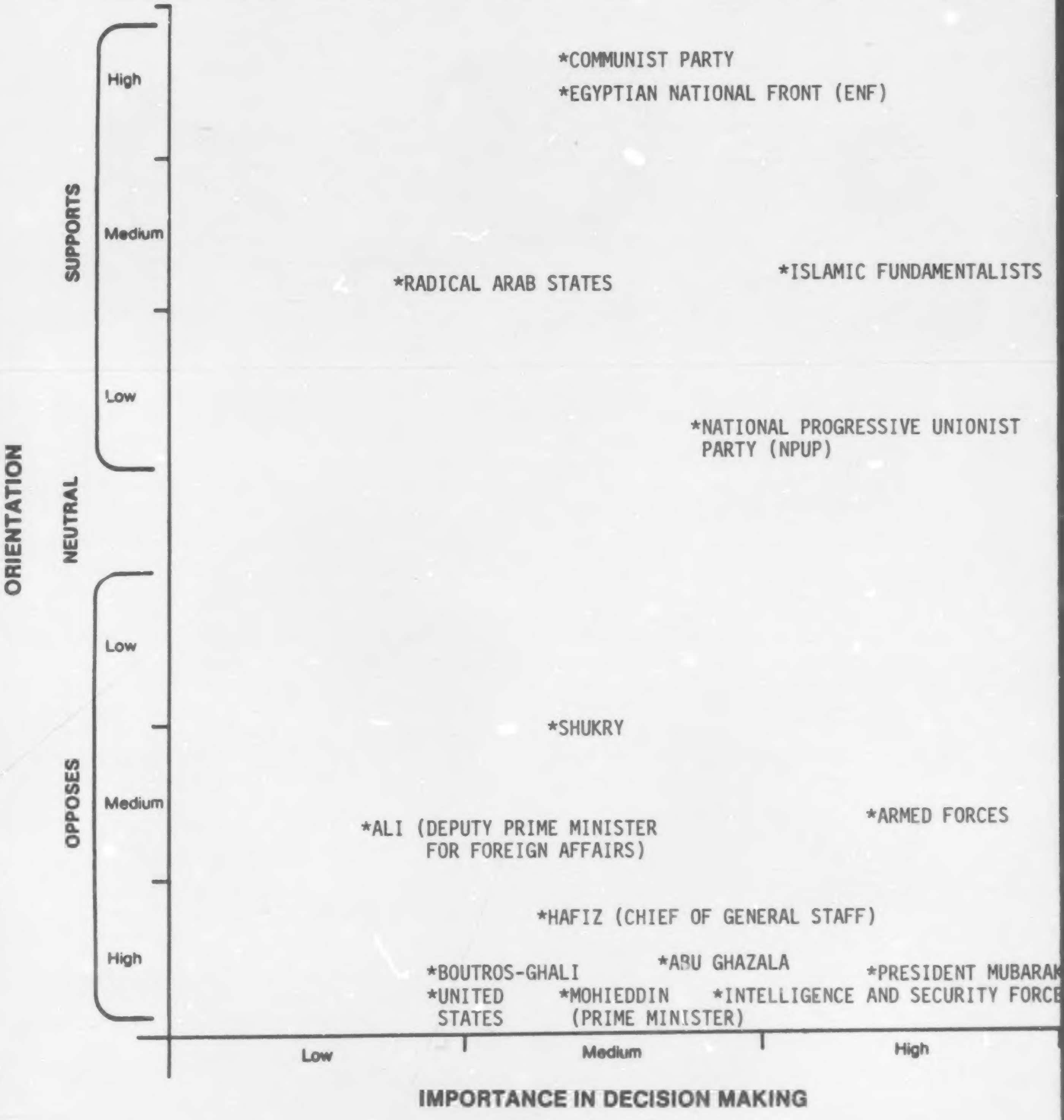
While odds are not high that an Islamic fundamentalist takeover will occur, if one did take place, it would be accompanied by massive turmoil. The supporters of the existing regime would resist, dividing the army and giving rise to the possibility of fighting among different military factions. This could serve as an excuse for outside intervention by the United States and Libya. The Islamic right itself is factionalized with some major portions now favorable to Mubarak; therefore, violence among the new ruling elite would also be possible. The new leaders would have to build a legitimacy which would probably include the identification of foreign scapegoats, presumably the United States and the West. Demonstrations against Western governments and multinational corporations would be likely.

DECISION STRUCTURE

POLITICAL TURMOIL

Country EGYPT

Date April 1, 1983



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RESTRICTIONS ON INTERNATIONAL BUSINESS

Summary

In order to attract foreign investment, the present government is likely to moderate any political inclinations it might have to increase restrictions. However, either a nationalist or an Islamic fundamentalist regime is likely to increase restrictions substantially.

Political Support and Opposition

While the majority of influential political actors support the liberal treatment of international business, a portion of the political spectrum does not do so and, if they ever attained power, would tighten up restrictions considerably.

President Mubarak and his advisers have a favorable attitude toward foreign investment, which they see as an important force in helping Egyptian economic growth. The government does feel, however, that these policies have not done enough to serve the interests of most Egyptians. President Sadat's policies created a small class of traders and local entrepreneurs who grew wealthy, while the average Egyptian gained little.

Mubarak and his new Cabinet have announced a program to both attract investment in areas with the highest potential for creating employment, and produce those goods deemed essential for the Egyptian market and goods that are export-oriented. The government has also emphasized the need to reduce bureaucratic red tape which has caused prolonged delays in the approval and implementation of new projects. In the past, companies have waited years for approval of projects, because the action of several agencies is required.

Wazih Shindi, minister of investment and international affairs, and Mustafa Kamal al-Said, minister of economy and foreign trade, have indicated that investment policy will be given a new direction and more efficient management. They have said that, except for projects to produce luxury consumer goods, approval will be much more rapid. They have also announced centralized decision-making in the General Administration for Investment and Free Zones (GAFI). Whether these changes will actually be implemented remains to be seen. The need for such changes makes it clear that the bureaucracy itself is not as open to foreign investment as the government leaders wish it to be.

Some of the opposition to the open-door policies, which exists despite Mubarak's modifications, is fostered by corrupt practices and the fact that little of the foreign investment has improved the standard of living of most Egyptians. Some opposition is based on ideological commitments that are likely to remain intense. On cultural grounds, Islamic fundamentalism opposes foreign investment as well as trade, while the left-wing opposition objects to the capitalist content of the policies necessary to attract foreign investment. These doctrinaire viewpoints do not now predominate, but a change in regime could give some of them significant power.

18-Month Forecast of Restrictions Under the Three Most Likely Regimes

EQUITY

CURRENT LEVELS: MODERATE. Joint ownership with constitutional guarantees against expropriation is encouraged. Article 4 of Law No. 43 embodies the general principle that approved projects must include at least some participation of public or private Egyptian capital. Exceptions would be for local currency banks (51% minimum local participation), construction contracting (50%), and consulting firms (49%), where no minimum participation is specified. Thus, investments must generally take the form of joint ventures, with certain exceptions. Housing projects may be undertaken only by Arab capital; no other capital, even with Egyptian participation, is allowed. Foreign capital does not need local participation to operate investment banks and merchant banks whose activities are confined to transactions in freely convertible currencies, provided such banks take the form of branches of firms whose principal offices are located outside Egypt.

Since 1974 Egypt's investment program has been designed to encourage participation of private Egyptian and foreign capital through offering lengthy tax holidays, prompt repatriation of profits and capital, exemption or deferment of customs duties, and other privileges. Although several millions of dollars of foreign private non-oil capital has been attracted, the bulk has been directed toward the banking and financial sector and to highly profitable consumer products. In addition, the implementation of approved projects has often been delayed by extensive bureaucratic bottlenecks. About three-quarters of industrial output originates in the public sector.

MUBARAK OR SENIOR MILITARY OFFICER: SAME. The open-door policy of Sadat will be somewhat modified to assure socially desirable results; but in no way will the general commitment to foreign investment be discouraged. While the regime will scrutinize foreign investments more closely to insure benefits for Egypt, the streamlining of the bureaucracy should facilitate equity investments. The net effect will probably result in about the same level of restrictions on international business as now exists.

NATIONALIST MILITARY COUP: MORE. This government would increase restrictions on equity ownership but avoid expropriation so as not to lose the confidence of investors.

FUNDAMENTALIST MILITARY COUP: MORE. This regime would seek to remove foreign control, but it would also attempt to protect its international financial position. More restrictions would be expected, but actions would be less extreme than in the case of Iran.

LOCAL OPERATIONS

CURRENT LEVELS: MODERATE. Utilization of indigenous management skills is encouraged. Foreigners, however, are often retained on a consulting basis.

Local content requirements are frequently made for new investments. A recent agreement with Daimler-Benz required a local content of 60% within five years. Also, a limit was placed on the number of trucks that could be sold inside Egypt.

Difficulties are often encountered in obtaining permits for imports. When goods arrive, customs clearance may be refused on grounds that locally produced substitutes are available.

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY MORE. Emphasis on the use of indigenous management will continue to be encouraged. Local content requirements will also increase.

NATIONALIST MILITARY COUP: MORE. The nationalist orientation of this regime would lead to additional pressures against hiring expatriates and using materials that could be obtained from within Egypt.

FUNDAMENTALIST MILITARY COUP: MUCH MORE. Foreigners, particularly Americans, would have great difficulty remaining in managerial positions. Increased self-sufficiency would also be pursued by more stringent local content requirements.

TAXATION DISCRIMINATION

CURRENT LEVELS: LOW. Foreign Investment Law 43 exempts profits on foreign enterprise from taxes for periods of five to fifteen years from the time production begins.

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY MORE. Those enterprises involved in production of goods deemed nonessential to the Egyptian economy or not serving to raise the level of employment in the country will not receive tax benefits at current levels.

NATIONALIST MILITARY COUP: MORE. Current exemptions would be reduced or eliminated by a regime seeking to build support among nationalists, leftists, and Islamic fundamentalists.

FUNDAMENTALIST MILITARY COUP: MUCH MORE. If foreign enterprises remained, they would be subject to extremely high levels of taxation. If oil production remained in Western hands, taxation would be far higher than present levels.

REPATRIATION

CURRENT LEVELS: LOW. Profits may be fully repatriated with no limitations five years after the initial investment. The government has been unable to supply sufficient hard currency at the official rate of exchange, leading companies to exchange on the black market and take a loss of at least 30% in the process.

MUBARAK OR SENIOR MILITARY OFFICER: SAME. The rules in repatriation will be altered so as to encourage enterprises likely to employ large numbers of Egyptians and to discourage projects that are not labor-intensive and likely to generate short-term profits for the investors. An effort will be made to eliminate foreign exchange difficulties due to lack of hard currency.

NATIONALIST MILITARY COUP: MORE. An accelerated decline in the foreign currency position,plus an ideological predisposition against foreign investors, would lead to some decreases in repatriation restrictions.

FUNDAMENTALIST MILITARY COUP: MORE. Foreign enterprises would find strict limits on the repatriation of profits. In the immediate aftermath of the Islamic takeover their assets in Egypt would probably be frozen.

EXCHANGE CONTROLS

CURRENT LEVELS: HIGH. Exchange controls are complex and multi-tiered. As an encouragement to foreign investment capital, foreign currency may be exchanged at the official incentive rate. In addition, each sector of the economy is given a quota of foreign exchange for all private trade conducted with public entities. Businesses that do not trade through official channels must often use less attractive exchange rates.

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY MORE. Present policies will continue, subject to some modifications. The direction of the economy has been reassessed and measures are being taken to ease many economic problems. Despite a decrease in the growth rate of foreign exchange earnings, economic expansion is expected to remain fairly high. However, continued economic decline could lead to additional restrictions.

NATIONALIST MILITARY COUP: MORE. The run on the Egyptian currency that would follow a coup would require increased restrictions on exchange.

FUNDAMENTALIST MILITARY COUP: MORE. Present policies would probably be significantly altered were Islamic Fundamentalists to take control, if only to counteract the capital flight that would inevitably follow.

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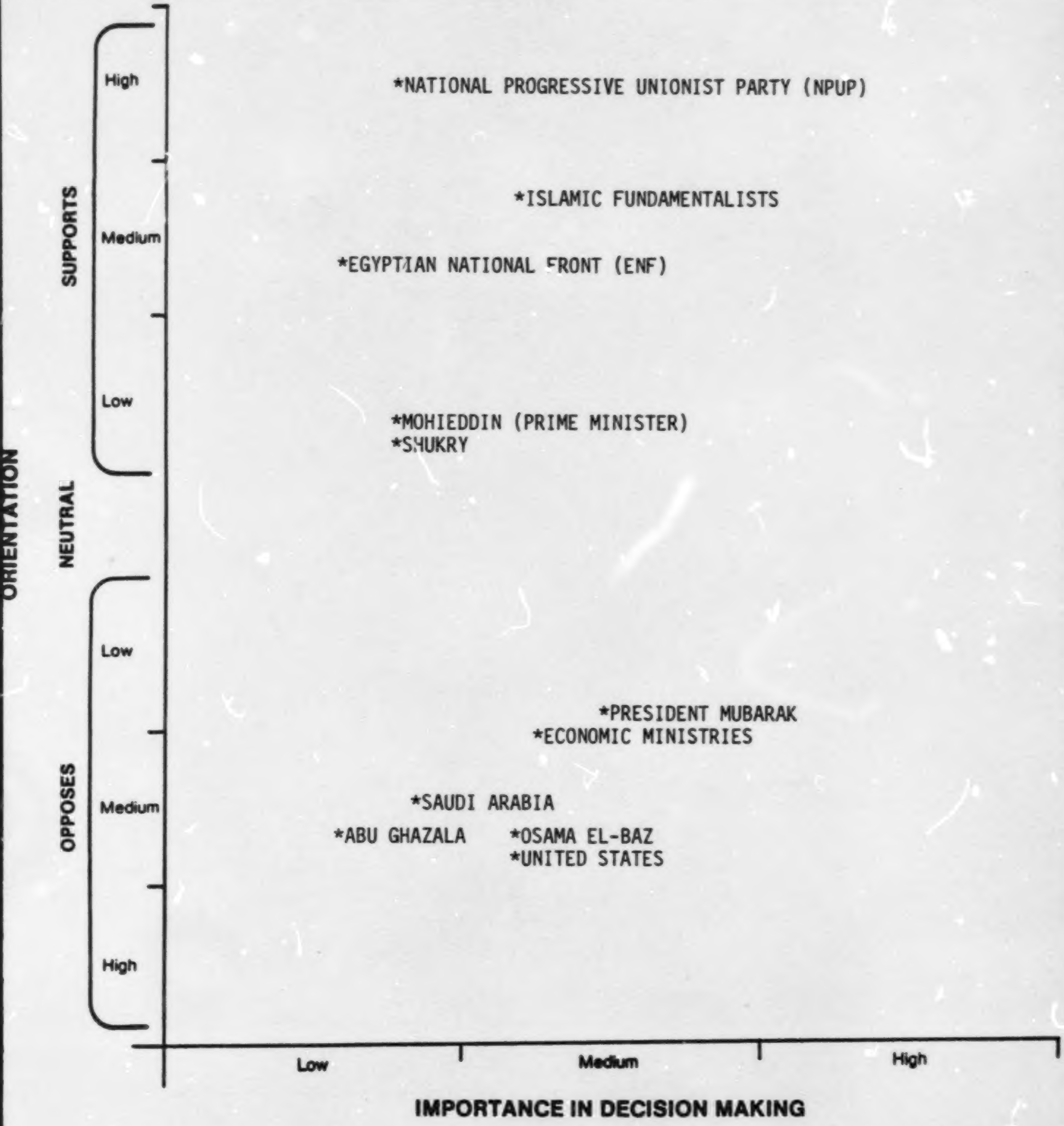
DECISION STRUCTURE

Country: EGYPT

Date: April 1, 1983

RESTRICTIONS ON INTERNATIONAL BUSINESS



TRADE POLICIES

Summary

Since Egypt seeks to protect its foreign exchange, restrictions on trade are likely to increase. The increase would be much greater if Mubarak were to be replaced by a Nationalist or Islamic fundamentalist regime.

Political Support and Opposition

The Mubarak regime is disturbed over Egypt's high import bill. In fiscal 1980 and 1981 the government spent $4 billion on food imports and another $2.1 billion on other imported goods. Private traders brought in another $1.2 billion in imports. In an effort to counter this trend, the government is likely to put strict limits on imports of nonessential goods through either quotas or high taxes. The economic policy-making team is virtually unanimous in recognizing the necessity of such steps. Opposition groups on both the right and the left would support this policy, since both were unhappy with the consumerism of the Sadat era. In addition, export promotion through public and private investment in industries geared toward exports is probable.

18-Month Forecast of Trade Policy Under the Three Most Likely Regimes

TARIFFS

CURRENT LEVELS: MODERATE. Tariffs on food, raw materials, and capital goods are generally lower than rates on luxury consumer goods. Consistent with the policy of curbing consumption of luxury goods, purchase taxes and customs duties are expected to yield an additional 39% and 34%, respectively, in revenue. Some of the key items affected include beer, cigarettes, gasoline, cosmetics, furs, and electrical and household goods.

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY MORE. Higher tariffs on categories of imports deemed luxury goods are a virtual certainty. In line with efforts to boost Egyptian manufacturing, measures will be taken to cut imports of products that compete with local manufacturers.

NATIONALIST MILITARY COUP: MORE. In an effort to increase revenues and discourage trade with the West, high tariffs on the import of goods produced in those countries would be imposed with allowances for capital goods and food imports. Tariffs on trade with the Soviet bloc would be negligible.

FUNDAMENTALIST MILITARY COUP: MUCH MORE. High tariffs on products imported from the West would be imposed, with food trade possibly excepted. Some incentives for trade with the Islamic and lesser developed states might be part of the regime's policy.

NON-TARIFF BARRIERS

CURRENT LEVELS: MODERATE. Hard currency deposits of 25% are required on imports of foodstuffs and raw materials, and a 40% hard currency deposit is necessary for imports of intermediate goods. A 100% prior deposit in hard currency is mandatory for purchases of luxury goods from abroad. Import permits to open letters of credit are required.

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MUBARAK OR SENIOR MILITARY OFFICER: MORE. An expansion of the system of import deposits will be implemented; imports of consumer products and products that the government feels can be produced locally will be curtailed.

NATIONALIST MILITARY COUP: MORE. Imports of consumer goods from the West would be subject to tight quotas; policies designed to open more trade with the Soviet bloc would be implemented.

FUNDAMENTALIST MILITARY COUP: MUCH MORE. A variety of quotas and other measures would be designed to limit imports of nonessential goods.

PAYMENT DIFFICULTIES

CURRENT LEVELS: MODERATE. Despite Egypt's economic problems, exporters report that payment delays are often less than 60 days. Conditions were expected to be worse over the past six months, but so far no significant deterioration has been encountered.

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY MORE. As economic conditions continue to decline and the reduction in oil prices contributes overall to a decline in foreign exchange, delays and risks are likely to increase modestly.

NATIONALIST MILITARY COUP: MORE. The capital flight and bureaucratic confusion that would accompany the ascendance of this regime are likely to create more delays and increase the risk of nonpayment.

FUNDAMENTALIST MILITARY COUP: MUCH MORE. The takeover by fundamentalists and consequent administrative disruptions would increase delays; business would suffer because of uncertainty about the regime's economic policies.

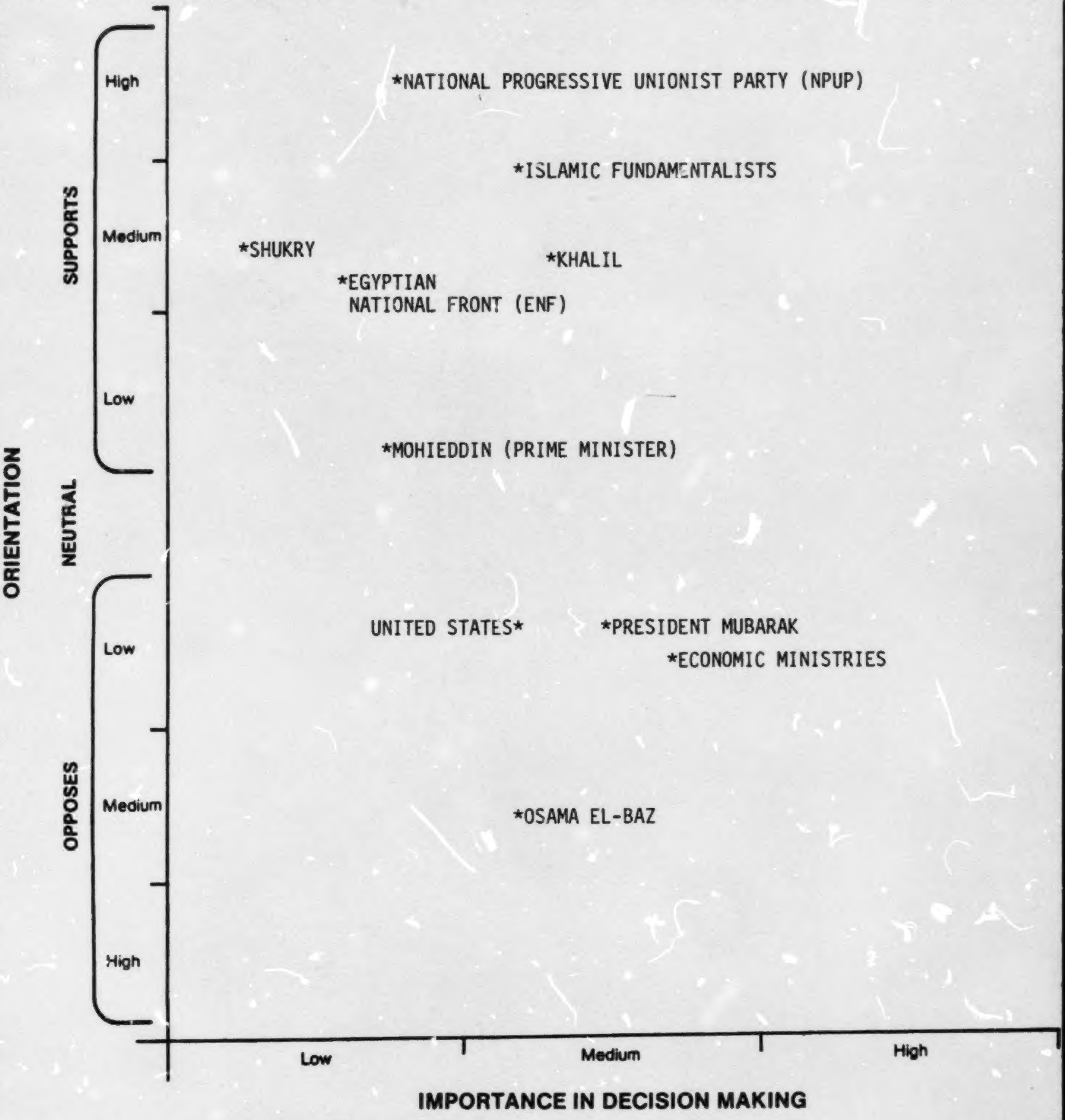
World Political Risk Forecasts

FROST & SULLIVAN

DECISION STRUCTURE

RESTRICTIONS ON TRADE

Country	EGYPT
Date	April 1, 1983



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ECONOMIC POLICIES

Summary

President Mubarak is committed to reducing the budget deficit and stimulating the economy. However, he will proceed cautiously in implementing the necessary policies, especially those relating to food subsidies. A Nationalist regime would initially pursue more inflationary policies, while an Islamic fundamentalist government would direct the economy away from its interdependence with the West.

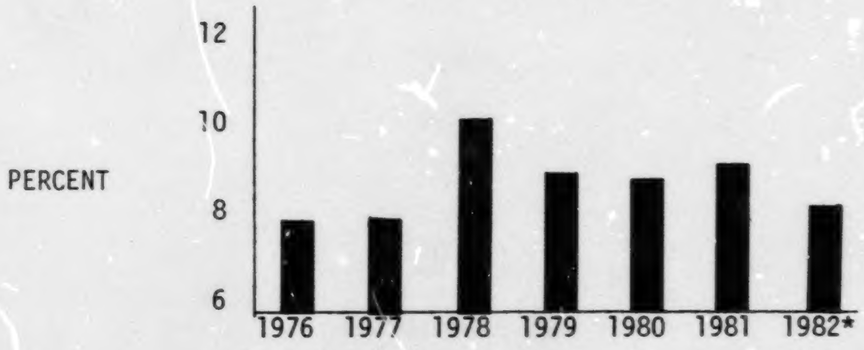
18-Month Forecast of Fiscal and Monetary Expansion Under the Three Most Likely Regimes

CURRENT LEVELS: MODERATE. The Egyptian economy has grown rapidly over the past five years as a result of four key external factors: petroleum exports, workers' remittances, tourism, and Suez Canal income. Massive foreign economic assistance has also helped to fuel substantial economic growth. However, in 1982, growth was slowed as foreign exchange earnings dropped, because of reduced workers' remittances and tourism. At the same time, inflation is estimated to have increased substantially.

The economic problems facing Egypt are related to its inability to check population growth, to increase agricultural production, and to develop industries that can compete in world markets. Political problems lie at the root of the economic difficulties. Food was subsidized by $2.4 billion in 1981, up from $1.3 billion ten years earlier. Public employees' salaries are over $2 billion. The budget deficit amounted to more than $5 billion in 1982, despite the attempt of the government to control spending.

The government has done some cutting, but has not touched subsidies or the government payroll. It has increased domestic interest rates, raised some utility rates, increased prices for premium gasoline, limited wage increases, and imposed taxes on certain luxury goods. Mubarak and his economic ministers have frequently stated that they recognize the problems and intend to do something about them. However, the memories of the 1977 food riots have kept the government from cutting the food subsidies so far.

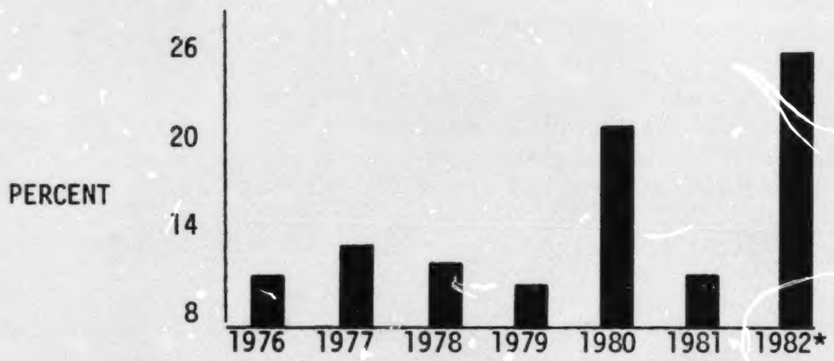
REAL GDP GROWTH



*Estimate

Source: IMF, International Financial Statistics.

INFLATION



*Estimate

Source: IMF, International Financial Statistics.

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY LESS. The next eighteen months will be crucial for the regime, because continued weakening of the currency and the mounting budget deficit will require significant restrictions if Mubarak is to satisfy the international financial community. However, given the limited latitude that his government has and the fear of precipitating riots, only modest restraints will be attempted.

NATIONALIST MILITARY COUP: MORE. This regime would be faced with the need to build support, particularly by improving the conditions of the lower classes. It is therefore likely to spend more than the current regime. It could also be faced with large increases in the cost of the armed services to maintain public order.

FUNDAMENTALIST MILITARY COUP: SAME. This regime might implement cuts in the size of the bureaucracy and development projects, but it would probably also increase subsidies for food and allow wages for the working class to rise somewhat. The overall effect would be little change from the current policies.

18-Month Forecast of Labor Cost Expansion Under the Three Most Likely Regimes

CURRENT LEVELS: MODERATE A rapidly growing youthful population has led to high levels of unemployment and underemployment. The government guarantees jobs in the public sector to all college graduates, and this has contributed to a bloated bureaucracy. The labor force is growing at an annual rate of 1.49%.

The lack of opportunity has resulted in over 2 million Egyptians working abroad, about 3% of the total work force. One benefit from this has been to relieve some of the pressure on the labor market for unskilled labor, since many of the Egyptians working overseas are unskilled agricultural and construction workers. Another benefit has been the considerable workers' remittances that are generated, helping Egypt's hard currency shortfall. However, significant numbers of skilled workers, including teachers, doctors, nurses, and other professionals, have emigrated to secure higher wages, and this has left Egypt with a shortage of skilled labor. In addition, the large number of overseas workers has allowed the

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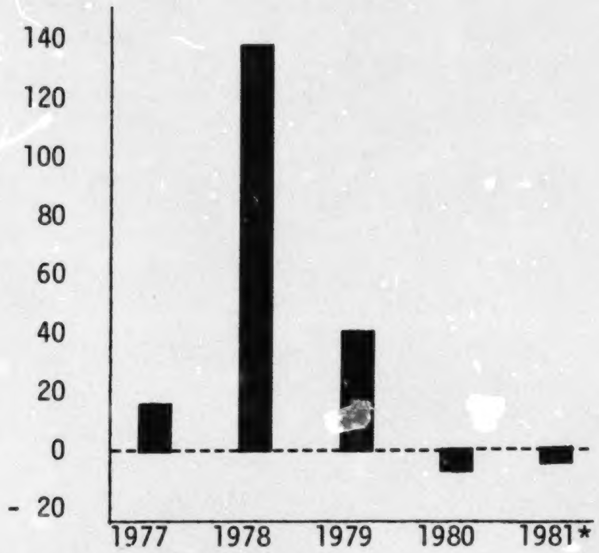
government to avoid the hard decisions necessary to create more productive jobs at home. As oil prices soften, as building plans in other Arab states are cut back, and as more Asians are hired in the Gulf states, Egypt's predominant role in supplying more than 30% of all foreign workers in the Middle East will start to decline.

Labor unions, a powerful political force under Nasser, have been relatively unimportant in recent years. Inflationary pressures have created demands for higher wages and the government responded with large increases in the late 1970s by raising the minimum wage. However, over the past three years, wages have not kept up with inflation.

CHANGE IN REAL WAGES



*Estimated

Source: Egyptian Embassy, Washington, D.C.

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY LESS. So far the present government has demonstrated opposition to wage increases. Unless there is a major threat of middle-class opposition, it can be expected to limit wage increases to slightly below the rate of inflation.

NATIONALIST MILITARY COUP: SLIGHTLY MORE. A nationalist military government might find it necessary to increase wages in order to build political support. However, it would be restrained by the economic realities and introduce only token increases.

FUNDAMENTALIST MILITARY COUP: MORE. An Islamic regime would probably legislate higher wage levels and mandatory workers' benefits. Some attempt would be made to establish cooperative ownership and management of industrial enterprises, with workers setting policy.

18-Month Forecast of International Borrowing Under the Three Most Likely Regimes

CURRENT LEVELS: HIGH. The current accounts deficit increased substantially in 1981 and eased only slightly in 1982. While exports have increased by about 13% over the last few years, imports have grown at annual rates closer to 25%. The growth has been due to increased imports of food, raw materials, capital goods, and, until the present government came to power, luxury goods.

The government took steps to reduce the luxury goods imports and generally has tightened up import restrictions. However, the continued need for food, raw materials, and machinery to help improve economic development will continue to contribute to a high import bill. In addition, the decline in oil revenues and the decrease of revenues from the Suez Canal as well as a leveling off in the flow of workers' remittances will also help to increase pressure on the currency.

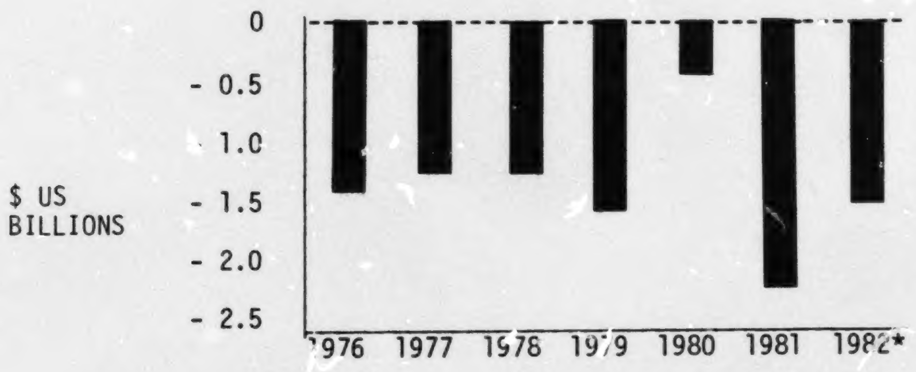
The debt picture has worsened during 1982, but with an estimated debt service ratio of 18.5% for 1982, it is not yet a serious problem. Egypt continues to be able to borrow money on international markets. However, a steeper decline in the current accounts, or a greater increase than is now anticipated in borrowing for international development purposes or to cover currency shortfalls, could lead to a financial crisis in a relatively short period of time.

A major reason for the relative solidity of Egypt's international finances is the volume and stability of foreign aid. Because of Egypt's strategic position in Middle Eastern politics, the government has been able to count on enormous financial support from the United States, Japan, and the EEC. Economic help from Saudi Arabia has increased as Mubarak has sought to improve the ties that Sadat had broken. If relations with the United States were strained and aid reduced, some of the loss of aid might be taken up by conservative Arab states.

In February 1983, the World Bank and the United States indicated support for the economic development plans of the Mubarak government. A total of $3.5 billion will be allocated by the United States to economic aid for Egypt between 1980 and 1985, with the bulk of it yet to be spent. In fact, one of the major problems has been that the Egyptian bureaucracy has been unable to carry out plans to spend the money that is available.

Foreign investment from private sources has been sought much more actively in 1982 than in previous years. The climate for foreign investment may improve sufficiently to attract investors.

CURRENT ACCOUNT



*Estimate
Source: IMF, International Financial Statistics.

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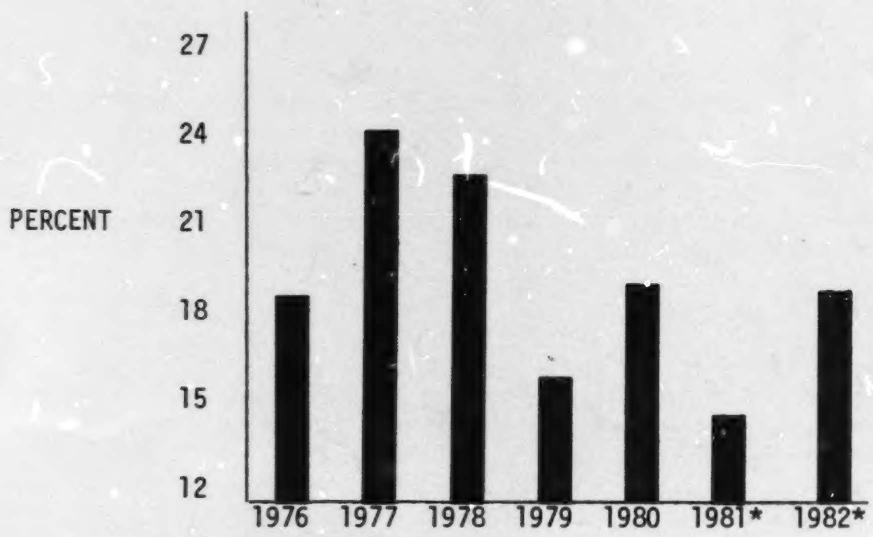
DEBT SERVICE AS A PERCENT OF EXPORTS



*Estimates

Source: World Bank, Annual Report.

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY MORE. The government will seek to increase the borrowing for economic development purposes and will try to reduce the borrowing needed to cover operating expenses. The net effect will be a slight increase in borrowing. A steeper or more prolonged economic decline than anticipated could accelerate the levels of borrowing.

NATIONALIST MILITARY COUP: MORE. This regime would attempt to borrow externally to finance its internal spending. Whether or not it will succeed in raising external funds will depend upon its policies. If it attacks corruption and appears to be pragmatic, it may win external support, particularly from conservative Arab states. If not, it may be forced to turn to more radical Arab states and ultimately the Soviet Union for external support.

FUNDAMENTALIST MILITARY COUP: LESS. This regime would break its links to Western nations and curtail its international borrowing. It may be able to get support from Iran, but in general its dependence on external financing would diminish out of necessity more than design.

FIVE-YEAR FORECAST

Summary

Mubarak has slightly better than a 50-50 chance of surviving the period. If he were to be replaced, it would be by a coup from either a coalition of nationalists or Islamic fundamentalists within the armed forces. The key factors will be whether economic conditions can be improved, Islamic fundamentalists can be controlled, and military discipline maintained. Much will depend upon external events, particularly the course of the world economy and the flare-up of violence within and between Egypt's neighbors.

Assumptions Underlying the Forecast

It is first assumed that the world and Egypt's economy will improve modestly with no sharp decline or rise. This assumption is important because of external revenues generated by oil sales and also the demand for other Egyptian exports. Second, it is assumed that no major war will break out in the Middle East, particularly involving Israel or Egypt itself. This assumption depends upon stability in Egypt's neighbors, especially Sudan and Libya. Third, it is assumed that Mubarak and other senior military leaders will remain in good health throughout the period. Fourth, it is assumed that the army will continue to hold the key to power throughout the period.

Most Likely Regime Scenario--Mubarak or Senior Military Officer (55% Likelihood)

Despite numerous opponents at home and abroad, Mubarak has slightly better than a 50-50 chance of surviving the five-year period. So far, he has taken significant steps to solve Egypt's chronic economic problems and to insure loyalty in the armed services, placating potential moderate dissidents on the right and left. Mubarak has shown himself to be a master at balancing competitive interests and building elite support.

Major questions do still remain. Can he actually make changes in the Egyptian economy? Bureaucratic inefficiency, a serious over-population problem which generates an ever-increasing supply of unemployed rural young people moving to the cities, and the fear of decreased subsidies or public spending may leave Egypt no better off economically in five years than it now is. Massive economic aid from the World Bank and Western governments will not be enough. Without making some progress, Mubarak could be faced with considerable opposition from the middle and lower classes if economic conditions do not improve. If he were forced to repress this opposition through military and police action, a major upheaval and army revolt could be the result.

It is also a problem to control the Islamic fundamentalists. While the organization of Moslems is tightly controlled and Mubarak has succeeded in gaining support from moderate Islamic leaders, he may not be able to maintain that control and support over time. The government's failure to control corruption and ostentatious expenditures along with continued abject poverty among the lower classes could turn the Moslems into a mounting opposition force. This could lead to support for a military overthrow or disruption in public order, inviting a military coup.

Mubarak has another problem, trying to move away from the United States and

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Israel without losing the economic aid resulting from Sadat's policies. Mubarak has already undertaken steps to establish some distance, but he will have to do more in order to placate Egyptian and Arab nationalists. As major events such as the 1982 Israeli invasion of Lebanon occur, Mubarak will be forced to take public stances that could lead to either a rupture with the United States or public demonstrations.

Finally, his continuation in power depends on his ability to maintain control over police, military, and intelligence forces. Mubarak and his defense minister, Halim Abu Ghazala, are not especially popular within the military, and personal resentment against both continues. Although the senior military leaders are loyal, and Mubarak has taken steps to insure that loyalty, it is difficult to maintain discipline in the lower ranks. Military equipment from the United States and the existence of numerous external threats will occupy the military; however, the possibility of a coup will continue throughout the period.

Second Most Likely Regime Scenario--Nationalist Military Coup (25% Likelihood)

As described in the 18-month forecast, junior officers representing Islamic fundamentalist or nationalist-leftist viewpoints could stage a successful coup. While the odds are against such an event, the possibility will continue throughout the forecast period. The largest danger will come from the impact of external events, particularly the Arab-Israeli conflict. A major embarrassment to the regime produced by Israeli actions could lead to both public demonstrations and a coup.

It is likely that a new government formed by such a coup would be inherently unstable as it sought to placate both Islamic fundamentalists and Nasserite nationalists. Factionalism within the armed services could develop, turmoil could reach civil war levels, and another coup would follow.

Third Most Likely Regime Scenario--Fundamentalist Military Coup (20% Likelihood)

The chances of an Islamic fundamentalist takeover by a military coup will increase throughout the forecast period. If economic conditions were not to improve and the strength of the fundamentalist movement were to build, pressure on their regime to take actions to placate fundamentalists would grow. These would consist of reducing foreign investment, distancing itself from the United States and other Western governments and ultimately returning to repressive policies. As these conditions develop, a group of army officers might make a move in conjunction with increased public disorders or following a nationalist coup. A fundamentalist regime would have trouble maintaining control under the threat of intervention from external forces and considerable internal opposition from the middle class and sections of the armed forces.

Forecast of Conditions Under Three Most Likely Regime Scenarios

POLITICAL TURMOIL

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY MORE. Sporadic violence will result from mass unrest, stimulated by economic conditions and occasional violence from the right and left.

NATIONALIST MILITARY COUP: MORE. Conflict between the left and right would create violence, as they seek to control the regime.

FUNDAMENTALIST MILITARY COUP: MORE. Turmoil would be generated by opposition to a fundamentalist regime and conflict within the military.

RESTRICTIONS ON INTERNATIONAL BUSINESS

MUBARAK OR SENIOR MILITARY OFFICER: MORE. Limits will be placed on foreign enterprises selling consumer and luxury goods or producing products deemed unnecessary for the Egyptian economy. Foreign banks will be required to provide a designated percentage of loans to local manufacturing.

NATIONALIST MILITARY COUP: MUCH MORE. The nationalization and expropriation of foreign business would be threatened. After two to three years some limited trade and investment relations would develop.

FUNDAMENTALIST MILITARY COUP: MUCH MORE. A broad range of restrictions on foreign enterprises would be initially implemented. With time, some easing would occur, especially where Western technology is needed.

RESTRICTIONS ON TRADE

MUBARAK OR SENIOR MILITARY OFFICER: SLIGHTLY MORE. Selective restrictions will be designed to discourage imports of nonessential goods and to conserve foreign exchange for food imports. If the foreign exchange situation improves these policies may be gradually reversed.

NATIONALIST MILITARY COUP: MUCH MORE. Some reorientation of trade would occur, including barter trade with the Soviet Union and the Communist world. The only imports from the West would be high technology goods.

FUNDAMENTALIST MILITARY COUP: MUCH MORE. A strict ban on imports of consumer goods from the West would occur for one or two years, followed by a gradual easing of the policy.

ECONOMIC POLICIES

MUBARAK OR SENIOR MILITARY OFFICER. The government is likely to maintain modest austerity measures and allow only small wage increases as it seeks to satisfy the international financial community and attract more foreign investment.

NATIONALIST MILITARY COUP. This government would pursue more inflationary policies and also attempt to increase international borrowing. If it were able to consolidate its power, it might eventually move to policies similar to those now followed by the Mubarak government.

FUNDAMENTALIST MILITARY COUP. This government would spend more on workers and their benefits, but would break away from dependence on foreign aid from the West and loans from Western financial institutions. The economic realities eventually might ameliorate their approach unless the government found itself in a war.

STUDENT EVALUATION FORM

Title of Learning Package Introduction to Political Risk Analysis

Course Title____________________ Name of Instructor____________________

Specific Parts of Learning Package Which Were Used. (If the whole package was used, please indicate this).

____

This questionnaire is designed to assist your instructor in evaluating the learning package you have just completed. You should answer the questionnaire in terms of that part of the learning package to which you were exposed. Answer the questions given below by circling the letter which corresponds to the response that most nearly agrees with your own. Please be frank since your comments will play a role in helping your instructor and the Consortium in improving the package in the future.

1. All things considered, this learning package was:

   a. excellent   b. good   c. fair   d. poor

2. To what extent did the learning package help you achieve the stated objectives?

   a. a great deal   b. some   c. little   d. not at all

3. On the whole, how much do you think you learned as a result of the learning package?

   a. a great deal   b. some   c. not very much   d. nothing

4. How would you describe your instructor's attitude toward the package?

   a. enthusiastic   b. neutral   c. negative

5. Please complete the following statement by circling the most appropriate letter after each adjective. When completing the statement, use the following code: a = Extremely   b = Very   c = Somewhat   d = Not at all.

   I FOUND THIS LEARNING PACKAGE TO BE:

INTERESTING	a	b	c	d	CHALLENGING	a	b	c	d
BORING	a	b	c	d	A WASTE	a	b	c	d
RELEVANT	a	b	c	d	PRACTICAL	a	b	c	d
INFORMATIVE	a	b	c	d	DEMANDING	a	b	c	d
DIFFICULT	a	b	c	d	DIFFERENT	a	b	c	d
GOOD	a	b	c	d	ENJOYABLE	a	b	c	d
STIMULATING	a	b	c	d	ENLIGHTENING	a	b	c	d
IRRELEVANT	a	b	c	d	EXCITING	a	b	c	d
WORTHWHILE	a	b	c	d	REWARDING	a	b	c	d
VALUABLE	a	b	c	d	PROVOCATIVE	a	b	c	d
NECESSARY	a	b	c	d	GENERAL	a	b	c	d
DULL	a	b	c	d	USELESS	a	b	c	d

6. Listed below are a number of analytic skills which may have been developed as a result of your completing this learning package. By circling the appropriate letter, please indicate the level of competence you felt in each skill before the package was used, and the level of competence you now feel in each skill after having completed the package. Please use the following code: a = None, b = Little, c = Some, d = A Great Deal.

SKILL	BEFORE				AFTER			
	None	Little	Some	A Great Deal	None	Little	Some	A Great Deal
Identify Major Sources of Political Risk	a	b	c	d	a	b	c	d
Determine Background Factors to Be Considered in an Analysis	a	b	c	d	a	b	c	d
Forecast Likelihood of Regime Change, Turmoil, or Restrictions Affecting Business	a	b	c	d	a	b	c	d
Calculate Risk Ratings Used to Compare Relative Risks in Different Countries	a	b	c	d	a	b	c	d

7. In the space provided, please list the specific ways in which the learning package could be improved.

8. In the space provided, please list those exercises in the learning package which you felt were of little value and indicate how they might be improved.

POLICY STUDIES ASSOCIATES

Policy Studies Associates was established in 1976 to strengthen learning resources which will help students develop policy analysis skills and techniques and apply these to important public issues. Toward this end, PSA is publishing two series of learning packages in policy studies designed especially for undergraduate use — ***Policy Sciences Series***, which emphasizes techniques in policy analysis, and ***Policy Issues Series***, which concentrates on specific public policy questions. The first series is a continuation of the learning packages in the ***Policy Sciences Series*** sponsored by the Public Affairs Program of the Maxwell Graduate School of Citizenship and Public Affairs at Syracuse University.

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